Witness Responsible:

James H. Vander Weide

1. Explain why Dr. Vander Weide did not use the Capital Asset Pricing Model as one of his estimation tools to develop his cost of equity recommendation.

Response:

In Dr. Vander Weide's opinion, the CAPM produces less reliable estimates of the cost of equity than other cost of equity methods at this time. First, the CAPM's risk factor, or beta, is meant to reflect the covariance between the return on an individual security in a single future period with the return on the market portfolio in that same future period. In practice, this data is not available. Instead, betas are measured using five years of historical data that may not reflect future expectations. Second, the market portfolio in the CAPM is meant to reflect a value-weighted portfolio of all possible risky investments. In practice, the market portfolio in CAPM cost of equity calculations is measured using an index of stock investments such as the S&P 500 or the index of all stocks traded on the New York Stock Exchange. In most cases, the indices used in cost of equity studies are poor proxies for a portfolio of all risky investments. Third, there is considerable evidence in the finance literature that the simple CAPM used in cost of equity studies omits risk factors that investors consider important in pricing risky securities, but there is considerable controversy about exactly which additional risk factors should be included. Fourth, the CAPM cost of equity is highly sensitive to the analyst's estimate of the risk premium on the market portfolio, yet there is disagreement in the literature regarding the measurement of the market risk premium. Some analysts use historical information without adjustment, some analysts use historical information with adjustment, and some analysts use ex ante risk premiums calculated using the DCF. Fifth, there is widespread agreement in the literature that the CAPM does not produce accurate estimates of the cost of equity for individual companies, especially companies whose betas are either higher or lower than 1.0. Sixth, the CAPM is a

Witness Responsible:

James H. Vander Weide

2. At page 4 of his Direct Testimony, Dr. Vander Weide states that his "recommended cost of equity is conservative because KAWC has significantly higher financial leverage, and, hence, greater financial risk, than my proxy companies." Provide the financial leverage for Kentucky-American and the proxy companies.

Response:

The financial leverage for KAWC and the proxy companies is provided on p.41, p. 42, and Schedule F of Dr. Vander Weide's direct testimony.

Witness Responsible:

James H. Vander Weide

3. At page 9 of his Direct Testimony, Dr. Vander Weide discusses the relatively high degree of fixed costs that water utilities experience. To what other entities is Dr. Vander Weide comparing water utility fixed costs?

Response:

Dr. Vander Weide is comparing the average fixed costs of water utilities to the average fixed costs of non-utility companies such as those in the S&P Industrials.

Witness Responsible:

James H. Vander Weide

4. a. State Dr. Vander Weide's estimate of the price elasticity of demand for water within the United States.

   b. State Dr. Vander Weide's estimate of the price elasticity of demand for water within Kentucky.

   c. Provide all reports, studies, and other materials upon which Dr. Vander Weide relies to respond to Items 4(a) and 4(b).

Response:

a. b. c. Dr. Vander Weide has not estimated the price elasticity of demand for water either in the United States generally or in Kentucky in particular.

Witness Responsible:

James H. Vander Weide

5. Describe the effect of Kentucky-American's proposed Emergency Pricing Tariff, which is designed to recoup lost revenues during drought when water usage is curtailed, on the demand uncertainty that Kentucky-American experiences.

Response:

KAWC has informed Dr. Vander Weide that it is not proposing the Emergency Pricing Tariff in this proceeding.

Witness Responsible:

James H. Vander Weide

6. At page 10 of his Direct Testimony, Dr. Vander Weide discusses increasing costs related to meeting changing drinking water standards, replacing aging facilities and expanding existing facilities to meet growing demand. List and describe the options available to Kentucky-American to recover these costs.

Response:

Dr. Vander Weide is aware of only one option for recovering these increased costs, namely, through increased rates.

Witness Responsible:

James H. Vander Weide

7. At pages 13, 14, and 16 of his Direct Testimony, Dr. Vander Weide presents the equation for the Discounted Cash Flow ("DCF") model and describes g as "the constant annual growth rate in earnings, dividends, and book value per share." He later states that he estimated the growth component in his DCF model, by using "the average analysts' estimates of future earnings per share (EPS) growth reported by I/B/E/S and the estimate of future earnings per share growth reported by Value Line." Explain why Dr. Vander Weide did not use growth in dividends and book value per share in his DCF model.

Response:

Dr. Vander Weide did not use growth in dividends and book value per share to estimate the growth component of the DCF model because consensus analysts' forecasts of future growth in dividends and book value are not readily available and his studies demonstrate that stock prices are more highly correlated with the I/B/E/S growth rates than with growth rates in dividends, and book value per share.

Witness Responsible:

James H. Vander Weide

8. Provide the following materials to which Dr. Vander Weide refers in his testimony:

   a. W. Carleton and J. Vander Weide, "Investor Growth Expectations and Stock Prices: the Analysts versus Historical Growth Extrapolation," The Journal of Portfolio Management (Spring 1988).

   b. Lee Inmoo, Scott Lochhead, Jay Ritter, and Quanshui Zhao, "The Costs of Raising Capital," The Journal of Financial Research, Vol. XIX No 1 (Spring 1996).

   c. Clifford W. Smith, "Alternative Methods for Raising Capital," Journal of Financial Economics 5 (1977).

   d. Richard H. Pettway, "The Effects of New Equity Sales Upon Utility Share Prices," Public Utilities Fortnightly, (May 10, 1984).

Response:

a. Please see attached electronic version KAW_R_PSCDR2#8a_attachment1_062804.pdf.
b. Please see attached electronic version KAW_R_PSCDR2#8b_attachment2_062804.pdf.
c. Please see attached electronic version KAW_R_PSCDR2#8c_attachment3_062804.pdf.
d. Please see attached electronic version KAW_R_PSCDR2#8d_attachment4_062804.pdf.

Witness Responsible:

James H. Vander Weide

9. Refer to the Direct Testimony of Dr. James H. Vander Weide at 19. Provide the stock price information from Standard & Poor's *Stock Guide* to which Dr. Vander Weide refers.

Response:

See attached file KAW_R_PSCDR2#9_attachment1_062804.xls.
See attached file KAW_R_PSCDR2#9_attachment2_062804.xls.

Witness Responsible:

James H. Vander Weide

10. a. Dr. Vander Weide states that all firms that sell securities in the capital markets incur some level of flotation costs and estimates the flotation cost to RWE, Kentucky-American's parent, at approximately 5 percent of an equity issue. Explain why, since the proceeds of most RWE equity issuances will not be invested in Kentucky-American, the entire flotation cost should be used to calculate Kentucky-American's cost of equity.

b. State whether in Dr. Vander Weide's opinion RWE is currently recovering any flotation costs from Kentucky-American.

c. Describe RWE's level of investment in Kentucky-American since the transfer of control of Kentucky-American to RWE.

d. List each RWE subsidiary that operates in the United States and that is a regulated public water utility, the state in which the subsidiary operates, the subsidiary's last return on equity ("ROE") award, the date of such award, and the amount or percentage of flotation cost used to calculate the subsidiary's cost of equity.

e. Describe RWE's current accounting treatment for flotation costs.

Response:

a. Dr. Vander Weide is not allocating RWE's entire flotation cost to KAWC. Since the cost of equity is multiplied by KAWC's rate base, he is only allocating KAWC's proportional share of the parent's flotation cost to KAWC.

b. RWE is currently not recovering any flotation costs from KAWC.

c. RWE purchased the common stock of American Water Works Co., Inc. KAWC has not issued additional common stock since the change of control and additional equity has been limited to that generated by retained earnings.

Witness Responsible:

d. Please see response and attachment to AG1-#81 for AWW organization structure. Please see response to LFUCG1-#15 for authorized ROE. There are few orders that specifically address floatation costs. Several of the Orders address stipulated ROE's and don't address ROE determination methods, other orders simply indicate an ROE from within the range of the various witness's recommendations.

e. RWE has not publicly issued common equity for a number of years. The Company does not have the information to provide the answer to this question in its possession at this time. As soon as it receives the information it will forward the information to the Commission.

Witness Responsible:

James H. Vander Weide

11. At page 26 of his Direct Testimony, Dr. Vander Weide testifies that he applied his DCF model to a proxy group of natural gas local distribution companies ("LDCs") that "are similar in risk to the water companies."

    a. State whether, when comparing the risk of these LDCs to water companies, Dr. Vander Weide is referring only to the business risks factor that he discusses at pages 9 and 10 of his Direct Testimony.

    b. Explain how the business risk factors discussed at pages 9 and 10 are similar for both water companies and LDCs.

    c. List and describe the business risk factors that water companies face but LDCs do not.

    d. List all reported decisions of which Dr. Vander Weide is aware in which a state regulatory commission accepted the use of natural gas LDCs as a proxy group for determining a water utility's cost of equity.

    e. List all state regulatory proceedings in which Dr. Vander Weide testified and advocated the use of natural gas LDCs as a proxy group for determining a water utility's cost of equity.

Response:

a. Dr. Vander Weide is referring to business risk generally, not only to the business risk factors discussed at pages 9 and 10 of his direct testimony.

b. Dr. Vander Weide's reasons for considering the business risks of the LDCs to be similar to the business risks of KAWC are described on page 27 of his testimony, Answer 53.

Witness Responsible:

James H. Vander Weide

c. The rising costs and uncertainty of meeting ever more stringent drinking water standards is a major business risk facing the water utilities that the LDCs do not face.

d. Dr. Vander Weide has not studied the decisions of state regulatory commissions to determine whether or not state commissions have used natural gas LDCs as a proxy group for determining a water utility's cost of equity. However, as he prepared his response to this information request, he happened across a memorandum from the Florida Public Service Commission Staff that provides the Staff's recommended cost of equity for water utilities in Florida. As described on the attached memorandum file KAW_R_PSCDR2#11_attachment_062804.pdf, the Florida Staff recommends using a natural gas proxy group to estimate the cost of equity for water utilities.

e. This is the first water utility case Dr. Vander Weide has testified in since the early 1990's. At the time of his previous water company testimonies, Dr. Vander Weide believed that there was a sufficient number and quality of publicly-traded water companies to estimate a water company subsidiary's cost of equity from a water company proxy group.

Witness Responsible:

James H. Vander Weide

12. a. State Dr. Vander Weide's estimate of the price elasticity of demand for natural gas within the United States.

    b. State Dr. Vander Weide's estimate of the price elasticity of demand for gas within Kentucky.

    c. Provide all reports, studies, and other materials upon which Dr. Vander Weide relies to respond to Items 12(a) and 12(b).

Response:

a. b. c. See response to PSCDR2#4.

Witness Responsible:

James H. Vander Weide

13. At page 30 of his Direct Testimony, Dr. Vander Weide states that "[p]revious studies have shown that the ex ante risk premium tends to vary inversely with the level of interest rates." State the reason(s), if any, that these studies provide for this inverse relationship.

Response:

The studies did not study the causes of the relationship between the ex ante risk premium and the level of interest rates. They only established the fact that the ex ante risk premium does vary with the level of interest rates. However, one plausible explanation for the inverse relationship between the ex ante risk premium and the level of interest rates is that the perceived risk of bonds increases when interest rates are high and decreases when interest rates are low.

Witness Responsible:

James H. Vander Weide

14. Explain why Dr. Vander Weide used information from January 2004 to estimate the ex ante risk premium on an investment in Kentucky-American.

Response:

Dr. Vander Weide used information from the period beginning September 2001 through January 2004 to estimate the ex ante risk premium on an investment in KAWC. The information for January 2004 was the most recent information available to Dr. Vander Weide at the time he prepared his testimony.

Witness Responsible:

James H. Vander Weide

15. Provide a copy of page 75 of Ibbotson Associates' *2003 Yearbook.*

Response:

Please refer to the requested information in file KAW_R_PSCDR2#15_attachment_062804.pdf.

Witness Responsible:

James H. Vander Weide

16. State whether Appendix 2 of Dr. Vander Weide's Direct Testimony has been published in a professional periodical or journal or has been submitted to a conference or other professional group. If it has been either published or submitted, provide the name of the publication or conference.

Response:

Dr. Vander Weide has not submitted Appendix 2 for publication in a professional periodical or journal because the information in this appendix is a summary of the literature, and Dr. Vander Weide has only submitted articles containing original research. Dr. Vander Weide has not submitted Appendix 2 to a conference or other professional group.

Witness Responsible:

James H. Vander Weide

17. List all reported state utility regulatory commission decisions of which Dr. Vander Weide is aware in which a state utility regulatory commission treated flotation expenses as an additional element of a firm's cost of capital or allowed rate of return.

Response:

Although Dr. Vander Weide has not studied which state regulatory commission have treated flotation expenses as an additional element of a firm's cost of capital or allowed rate of return, he is aware at the least that Illinois, Maine, and Florida treat flotation expenses as an additional element of a firm's cost of capital. Also see attachment to the response to file name KAW_R_PSCDR2#11d_attachment_062804.pdf.

Witness Responsible:

Michael A. Miller

18. For each RWE subsidiary or affiliate that is a regulated water utility, identify each proceeding since January 1, 2002 in which the subsidiary or affiliate requested a rate adjustment, the regulatory commission in which the proceeding was conducted, the case number of the proceeding, and the date on which the proceeding was initiated.

Response:

Please see attached file KAW_R_PSCDR2#18_attachment.pdf.

Witness Responsible:

Linda Bridwell

19. Provide Kentucky-American's total water sales volume, by customer class for each quarterly period since January 1, 1999. Fore each quarterly period, also provide a brief description of precipitation and temperature conditions.

Response:

Please see attached file KAW_R_PSCDR2#19_attachment_062804.pdf.

Witness Responsible:

James H. Vander Weide

20. Explain why Dr. Vander Weide did not include in his Direct Testimony a schedule similar to Schedule C that included his proxy water companies.

Response:

Dr. Vander Weide did not include a schedule similar to Schedule C that included his proxy water companies because his ex ante risk premium study is time consuming and expensive to prepare initially and to maintain. Dr. Vander Weide had previously prepared his ex ante risk premium study for a natural gas proxy group, and it was significantly less time consuming and expensive to update that study than to create a new study based on a proxy group of water companies. In addition, there are very few publicly-traded water companies and these companies are followed by very few analysts. Thus, it is difficult to obtain the necessary data for these companies over a long period on a consistent basis.

Witness Responsible:

Michael A. Miller

21. State whether RWE has access to and uses financial markets outside of the United States when it issues debt instruments or equity.

Response:

Yes.

Witness Responsible:

Michael A. Miller

22. Describe how RWE raises its capital and allocates this capital to its subsidiaries and affiliates.

Response:

The "Share Profile" and "Bonds" areas of the Investor Relations section of the RWE website (www.rwe.com) provides information regarding the capital stock and bonds of RWE. Pages 20 and 21 of the 2003 RWE Annual Report (filed with the Commission in compliance with requirements of the order approving the RWE transaction) discuss its debt financings. The 2003 RWE Annual Report also contains additional information regarding long-term debt financings throughout the report, including the Consolidated Financial Statements and notes to financial statements section.

Witness Responsible:

Michael A. Miller

23. Describe the process under which Kentucky-American would obtain capital investment from RWE for new capital expenditures.

Response:

KAWC obtains its debt, both Long-term and Short-term, from American Water Capital Corp. through the agreement with AWCC approved in case number 2000-189. The Company expects to continue using AWCC to obtain its debt capital. Please see response to LFUCG question #81 that describes the involvement of RWE. AWCC will continue to obtain the debt at the best possible price in the market place. The Company has not required additional equity other than through retained earnings for a number of years. If the Company needed additional equity to maintain the proper capital structure ratio's it would request that equity capital from American Water Works Co., Inc.

Witness Responsible:

Michael A. Miller

24. State the conditions under which a subsidiary or affiliate of RWE may publicly issue its own debt or equity to persons or entities not related to RWE or RWE affiliates.

Response:

The Company is not familiar with financing conditions applicable to RWE subsidiaries or affiliates other than those with whom it participates in obtaining capital through American Water Capital Corp (AWCC). Under the agreement of Kentucky-American and AWCC, participants can issue their own debt and preferred stock securities when the long-term cost of capital for those securities is less than long-term capital costs available from AWCC.

Witness Responsible:

Michael A. Miller

25. List each debt and equity issuance that RWE has made since January 1, 2001. For each issuance listed, state the date of the issuance, its purpose and the extent to which the proceeds of the issuance were used for the acquisition of the assets of or control of another entity.

Response:

The "Bonds" areas of the Investor Relations section of the RWE website (www.rwe.com) provides the requested information regarding the bonds of RWE.

Witness Responsible:

Michael A. Miller

26. At pages 65 and 66 of his Direct Testimony, Michael M. Miller states that the 25 percent reduction in rates for low-income customers should be recovered by spreading "the cost of the discount across all customer classes."

    a. Identify the benefits, if any, that other customers receive as a result of Low Cost Customer Tariff.

    b. Explain why requiring other customers to assume the cost of the discount is fair and reasonable.

    c. State whether, if the cost of the discount is spread across all customer classes, low-income customers will be allocated a portion of the cost of the discount.

Response:

a. The Company has not conducted a study to determine the benefits other customers may receive from implementation of the low income tariff. The purpose of the low income tariff is to provide assistance to those customers who have the most difficultly in paying monthly utility bills and along with other monthly requirements. The Company is aware that some states provide this type of assistance through legislative efforts that permit the Company to credit those customers and recover the cost of the program from through its tariffs. In other states the commission has approved tariffs similar to the one proposed by the Company. The Company believes the cost to the remaining customers of 2.5 cents per customer per month is a reasonable price to help those customers at or below the federal poverty levels who likely have difficulty each month in paying their utility bills.

b. See answer to 26 (a).

c. Yes, the Company does not know of any way to avoid this unless an entirely separate general service tariff was established for the low income customers. That approach

Witness Responsible:

Michael A. Miller

could not be implemented until history was developed and the Company does not believe that would be easily managed or that for the minimal cost spread to the low income customers under the Company's proposal, cost effective.

Witness Responsible:

Coleman D. Bush

27. a. State the amount of funds from the "Water for Life Fund" that were distributed to customers or used to reduce customer bills in 2003.
    b. State the number of customers that benefited from the "Water for Life Fund" in 2003 in the form of reduced bill or billing credit and the total amount of bill reduction or credit.
    c. List each use that Kentucky-American made of the "Water for Life Fund" in 2003.
    d. Describe how Kentucky-American identifies customers who were to receive reduced bills or billing credits from the "Water for Life Fund." Provide all written policies and operating procedures for the fund.

Response:

a. $5,286.71
b. 86 customers. "Water for Life" does not involve any reduced billing or billing credits. Community Action Council, the agency that administers the fund, issues a check to Kentucky American Water in payment for part of all of a water bill.
c. We do not have a listing of individual beneficiaries of the fund distribution.
d. The Community Action Council administers eligibility according to Federal poverty guidelines. See attached file KAW_R_PSCDR2#27d_attachment_062804.pdf for a copy of our agreement with Community Action Council.

For more information on this subject, please refer to AGKYDR1#4, #11 and #12.

Witness Responsible:

Michael A. Miller

28. Explain how, in the absence of any express statutory authority to provide a separate customer classification based upon a customer's income, the Commission may authorize the "Low Income Customer Tariff" assistance for low-income customers.

Response:

Kentucky-American Water Company may use reasonable considerations for reasonable classifications of rates. KRS 278.030(3). Kentucky-American Water Company believes that utilization of Federal Poverty Guidelines for a classification of rates is reasonable. The "subsidization" that may be created by the Commission's approval of the proposed Low Income Customer Tariff is philosophically no different than requiring the cost of service to a particular area to be borne system-wide rather than by customers in the particular area.

Witness Responsible:

Michael A. Miller

29. a. List each American Water Works Company affiliate or subsidiary that has established a Low Income Tariff or similar program.

b. For each entity listed above,

(1) Provide a copy of the tariff and all policies or operating procedures for the operation of the tariff.

(2) Describe the results of the entity's tariff. Provide all reports, audits, or regulatory commission reviews of the entity's tariff.

Response:

a. Please see the attached file KAW_PSCDR2#29_attachment_062804.

b. (1) Pennsylvania-American is the only subsidiary of American Water that has an approved Low Income Tariff. West Virginia-American currently has pending in its rate case a low income tariff. The WVAWC tariff is very similar in form to the requested tariff for KAWC in this case, in that it requests a 25% discount on the meter charge (minimum allowance) portion of the tariff for eligible participants. The PAWC tariff is very similar to the proposed KAWC tariff and PAWC requested and was granted in its 2003 rate case an increase in the discount from 25% to 50% of the service charge for eligible participants.

(2) The Company does not have reports, audits, or commission reviews of the PAWC tariff. The WVAWC tariff is under consideration in the rate case currently filed.

Witness Responsible:

Michael A. Miller

30. List each American Water Works Company affiliate or subsidiary that has established a voluntary assistance or contribution program and describe the results of that program. The description should include the level of monies collected in 2003 and a discussion of the efforts to publicize and promote such program.

Response:

Please see attachment to the response to question 29 (a) above.

Witness Responsible:

Michael A. Miller

31. State Kentucky-American's position on any condition to the implementation of the Low Income Tariff that requires Kentucky-American to assume a share of the cost of the discount equal to that borne by Kentucky-American ratepayers.

Response:

Kentucky American's stockholders currently support assistance to low income users through its "Water for Life" program. The proposed tariff places the additional assistance on the customer base in a manner similar to programs approved in other jurisdictions. This assistance is provided at a minimal and reasonable cost to the customers. The proposed tariff is intended to supplement the assistance to those customers in the most need of assistance in addition to the assistance already provided by the stockholders of Kentucky American.

Witness Responsible:

Michael A. Miller

32. Describe Kentucky-American's proposed method of allocating the cost of discount resulting from its proposed Economic Development Tariff among its remaining customers and its shareholders.

Response:

The Company is not asking for approval of that tariff at this time. The Company envisions that it would absorb that discount until such time as a general rate filing incorporated that transaction into the approved cost of service. In that general rate filing the additional revenue from the new customer (net of the discount that is applicable to the test-year) would be incorporated into going level revenue and the net benefit passed of the transaction would flow to the customers.

Witness Responsible:

Michael A. Miller/Coleman D. Bush

33. Identify each American Water Works Company subsidiary that assesses an activation fee, provide a copy of its tariff sheet setting forth such fee, and describe how the fee is calculated.

Response:

Please see files KAW_R_PSCDR2#33_attachment1_062804.pdf and KAW_R_PSCDR2#33_attachment2_062804.pdf.

While the fees are generally based on the cost of providing the service or some components thereof, some of the tariffs are quite old and the fee does vary from company to company. We have attached file KAW_R_PSCDR2#33_attachment2_062804.pdf, which includes the development of the fee for Virginia American Water and will provide details for others when and if they become available.

Witness Responsible:

Coleman D. Bush/Michael A. Miller

34. List all non-American Water Works Company water utilities of which Coleman Bush is aware that assess an activation fee.

Response:

Please refer to the response to AGKYDR1#9.

Witness Responsible:

Coleman D. Bush

35. State whether a customer may be assessed both an Activation Fee and a Reconnection Fee when service is reconnected or restored.

Response:

The activation fee is for initiation of service when the service has not been disconnected for nonpayment of a bill. The reconnection fee is for reconnection of service for the same customer whose service has been terminated for nonpayment of a bill. Only one fee would be assessed based on the reason for the service call.

Witness Responsible:

Coleman D. Bush

36. Refer to the Direct Testimony of Coleman D. Bush, Exhibit 2. For miscellaneous expense allocated to direct service order labor, describe how the allocation was made.

Response:

Please refer to file KAW_R_AGKYDR1#20_062504.xls filed in response to the first request for information from the Attorney General. By following the spreadsheet formulas, one can see how all allocations are made.

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Witness Responsible:

Coleman D. Bush

37. At page 15 of his Direct Testimony, Mr. Bush refers to a "dramatic increase in costs including enhanced communication and community education and more frequent meter readings" resulting from a drought emergency. Describe what Mr. Bush means by "dramatic increase in costs."

Response:

Please refer to response to AGKYDR1#23.

Witness Responsible:

Coleman D. Bush

38. Refer to Direct Testimony of Coleman D. Bush at 15. State how frequently, in Mr. Bush's opinion, formal meetings with the Commission would have to be held while the Emergency Pricing Tariff is in effect.

Response:

Since neither the Company nor the Public Service Commission has experienced true water rationing since 1930, it would be difficult to assign a frequency for such meetings. In the event that water rationing should be necessary in the future, I believe that all parties would agree today that it is impossible to predict all of the possible outcomes of such an event. I suggested a formal Commission meeting to help bring focus to service and financial outcomes. I believe that the outcome of the initial meeting would dictate the frequency of subsequent meetings.

Witness Responsible:

Linda Bridwell

39. Refer to Direct Testimony of Linda C. Bridwell at 29.
    a. Describe the bidding process through which Kentucky-American selects contractors.
    b. Describe the qualifications that a contractor must meet to be eligible to participate in the bidding process.
    c. Provide a copy of the most recent request for bids that Kentucky-American issues to contractors.
    d. State the number of contractors that Kentucky-American awarded with contracts to make new tap installations for each year since January 1, 2000.
    e. Describe how, if Kentucky-American has more than 1 contactor performing serviced tap installations, a contractor is assigned to perform a service tap installations.
    f. State whether Kentucky-American conducts separate bid solicitations for its Central and Northern Divisions.
    g. State whether different contractors are used for Kentucky-American's Central and Northern Divisions.

Response:

a. Kentucky American Water maintains a list of pre-qualified pipeline contractors. In order to qualify, a contractor must fill out a detailed application that includes credit references, work references, lists experience, equipment, personnel, insurance and licenses. If the application demonstrates adequate work experience, and references vouch for financial stability and adequate work performance, the contractor is then interviewed individually. The contractor is given a set of pipeline specifications prior to the meeting, and the meeting is utilized to further discuss experiences and answer questions about Kentucky American Water expectations. A contractor is then granted a probationary status on the bid list for a period of six to twelve months depending on the work history of that contractor. Probationary contractors are generally limited in size of projects they may bid on and are limited in the number of bids they awarded at any one time. If satisfactory work is performed, the contractor is granted qualified status although they may still be limited in the size of projects they may bid. All contractors are required to attend occasional meetings to review changes in work policies or regulations. Contractors may be removed from the bid list for poor performance, safety violations, or for not bidding on projects for an extended period.

Witness Responsible:

Linda Bridwell

For the new services contract, all pre-qualified pipeline contractors are invited to bid. A pre-bid meeting is held prior to bid solicitation, and bids are due late in the year. Probationary contractors are not invited to bid on the new services contract. Kentucky American then awards one contract for all new services for year in the Central Division. The contract is not exclusive, and Kentucky American Water reserves the right to include new services in a pipeline contract where cost feasible or install with company personnel. At the end of the year, if performance has been good and prices are reasonable, the contractor may be asked if they wish to extend the contract for an additional year.

b. The contractor must be a pre-qualified pipeline contractor with a proven work history with Kentucky American Water.

c. Please see the attached file KAW_R_PSCDR2#39c_attachment_062804.pdf.

d. Two.

e. Only one contractor has been assigned a blanket contract per year. Occasionally a large multi-family development project will include the installation of all new services with the pipeline construction if cost effective.

f. Currently, Kentucky American does not have a blanket contract for the Northern Division. Some new services in the Northern Division have been installed by the pipeline contractor on main extension projects, some by company personnel, and some by the Central Division contractor.

g. See the response to item f above.

Witness Responsible:

Linda Bridwell

40. State why Kentucky-American bases its tap fees on a 3-year average cost of the installation of new services.

Response:

The cost per tap varies each year based on a number of factors including the number of taps, the number of "short" vs. "long" taps, and the number of dual services. This is in addition to the per tap cost of materials and contract installation. By using a three-year cost average Kentucky American Water can smooth out fluctuations that may occur because of a change in the number of taps on any given year, but still use recent enough history for the pricing to be current.

Witness Responsible:

Linda Bridwell

41. State why, if a single contractor performs all installations of new services, tap fees are not based upon current costs as opposed to an average cost.

Response:

Kentucky American Water believes that an average historical cost over a short, recent period helps eliminate cost fluctuations that may result from a variation in the number of taps during the year.

Witness Responsible:

Linda Bridwell

42. Refer to the Direct Testimony of Linda C. Bridwell at 30.

    a. Explain why Kentucky-American's labor costs have increased due to more stringent verification of the accuracy of work and tracking of materials.

    b. Explain why Kentucky-American's assumption of additional duties previously held by contractors would not result in lower contract labor costs and offset at least a portion of Kentucky-American's increased labor costs.

    c. Identify the cost savings achieved as a result of Kentucky-American's assumption of responsibility for purchasing and tracking materials from contractors.

    d. Describe "the insurance issues following September 11, 2001"to which Ms. Bridwell refers and how these issues have affected the cost of serviced installations.

Response:

a. Historically when service material has been out of balance it was difficult to determine hether it was a result of new services, managed through the construction department, or contract service renewals or maintenance, both managed through the distribution department. Tracking the material was labor intensive and differences in inventory balance were hard to resolve. In 2000, Kentucky American attempted a cost savings measure to have its service contractor purchase and account for all materials for new services, thus eliminating the need for tracking within the construction department and eliminating one source of inventory variances. Vendors agreed to provide materials at the same national contractor prices to the designated contractor, and the contractor would be paid a handling fee. By 2002, the contractor expressed concern that some vendors were unwilling to continue to offer the national contract price from American Water Works to them. Kentucky American Water

Witness Responsible:

Linda Bridwell

elected to segregate materials and begin purchasing all service materials in 2003. By that time, all service renewals and new services were the responsibility of one individual. However, this change required increased labor costs for stock purchasing and inventory management.

b. Because of the way the services are bid, it is difficult to determine a direct cost reduction in the contract labor price due to eliminating the responsibility for purchasing and storing materials. However, from 2002 to 2003 the contract price for a new 1" service line, dropped on average $17 while the contract labor cost for ¾" service lines dropped on average $53. The contractor labor cost of a new ¾" meter installation increased by $8 while the contractor labor cost of a 1" meter installation increased by $13. This overall cost savings in contractor labor from 2002 to 2003 has offset some of the increased company labor costs.

c. It is impossible to quantify the cost savings achieved as a result of the assumption of responsibility for purchasing and tracking materials from contractors. The overall materials costs for 1" services dropped on average $2 from 2002 to 2003. The overall materials costs for ¾" service lines dropped $35 from 2002 to 2003. The overall materials costs for meter installations increased in 2002 to 2003 due to the need to purchase a different type of meter setter for a large number of services with potentially high pressure.

d. In late 2002 and again in 2003, Ms. Bridwell spoke with a couple of the contractors to determine if there was a specific cost driver behind the increasing cost of tap installations and overall pipeline installation cost increases. The contractor indicated that a number of issues had led to pricing increases in their bid including the increase fuel costs. Additionally, after September 11, 2001 Kentucky American Water began requiring all contractors perform a background check on all of their employees that will be working on Kentucky American Water property. While the cost of the

Witness Responsible:

Linda Bridwell

background is not significant, contractors have indicated that they have been required to increase wages in order to maintain an adequate level of staff that successfully passes the background check. Finally, the contractors indicated that their insurance premium costs had gone up significantly following September 11, 2001.

Witness Responsible:

Linda Bridwell

43. Identify who (i.e., Kentucky-American employee or contractor) performs service connection installations for Kentucky-American's Northern Division.

Response:

Currently, there is not a single process for service connections in the Northern Division. Some installations on the New Columbus were installed by the pipeline contractor if the customer's tap application was submitted by the time the line was placed in service. The Northern Division generally installs 50-60 new services per year, and they are installed by the Kentucky American Water personnel. A few new services are installed by the Central Division new services contractor outside of the blanket contract when Kentucky American Water personnel are engaged in other activities or when it is a particularly difficult installation.

Witness Responsible:

Linda Bridwell

44. Explain why Kentucky-American is proposing the same tap fee for 1-inch and 2-inch service for both Divisions, but proposes different fees for each division for 5/8-inch services and larger size services.

Response:

The 5/8" tap fee was already established for both Elk Lake and Tri-Village. When Kentucky American Water acquired those systems, the company adopted their tap fee. There have been a few 1" tap requests in the former Tri-Village system. Previously, Tri-Village Water District would account for those charges and bill the customer. Since there are so few, it is difficult to establish an average cost, however, to simplify customer service and accounting, Kentucky American Water proposes to adopt the Central Division tap fees for 1" and 2" for the former Tri-Village area until a longer history of those costs is established.

Witness Responsible:

Linda Bridwell

45. Refer to Kentucky-American's Application, Exhibit 3 at 3. Explain why Kentucky-American's proposed tap fee for 1-ich and 2-inch services for Northern Division-Elk Lake is listed in listed in its Notice as "Actual Cost" but is listed in Ms. Bridwell's Direct Testimony as $945 and $4,250, respectively.

Response:

Ms. Bridwell's Direct Testimony was incorrect. Because there have been no requests for either 1" or 2" taps in the Northern Division-Elk Lake system since Kentucky American Water acquired the system, Kentucky American Water proposes to leave the tap fees at actual cost.

Witness Responsible:

Linda Bridwell

46. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), Workpapers 9-1 at 1. The column labeled "2004 Meter" lists $45 for 5/8-inch meter, $82 for 1-inch meter, and $299 for 2-inch meter. Explain how these amounts were established.

Response:

These costs are based on current meter prices for encoder meters including tax. Kentucky American Water now installs all new meters as either encoder or AMR meters, and only uses traditional meters for a few 5/8" meter replacements required under the meter change out program where meters on the same route are also traditional meters.

Witness Responsible:

Dr. Edward L. Spitznagel

47. Refer to Direct Testimony of Dr. Edward L. Spitznagel at 2. State the number of companies screened in Dr. Spitznagel's model that are <u>not</u> subsidiaries of American Water Works Company.

Response:

All companies involved in the screening stage were subsidiaries of American Water Works Company.

Witness Responsible:

Dr. Edward L. Spitznagel

48. Identify the other variables that Dr. Spitznagel considered in his model in addition to those identified at Page 4 of his Direct Testimony.

Response:

In addition to the Palmer Drought Severity Index, five other moisture variables were tested: PHDI, PMDI, and ZNDX (three additional Palmer drought indices), average daily precipitation, and the available soil moisture index developed by Dennis Patterson of the Missouri Public Service Commission staff. In addition to cooling degree days, three other temperature measures were tested: mean daily temperature, maximum daily temperature, and minimum daily temperature. Every measure was tested as-is and with lags to allow for delayed effects.

Witness Responsible:

Dr. Edward L. Spitznagel

49. Refer to Direct Testimony of Dr. Edward L. Spitznagel at 4.

  a. Describe how Dr. Spitznagel's projections of residential and commercial customer daily utilization in this proceeding compare to those in previous proceedings before this Commission.

  b. Describe the developing trends in average daily utilization, if any, that Dr. Spitznagel finds from his modeling.

  c. State the implications of these developing trends, if any, on Kentucky-American's costs of production and revenues from water sales.

Response:

a. For <u>residential</u> utilization, the four estimates were:

Oct1997-Sep1998:	184.82	Gal / Cust Day
Jan2000-Dec2000:	184.66	Gal / Cust Day
Dec2000-Nov2001:	183.94	Gal / Cust Day
Dec2004-Nov2005:	165.42	Gal / Cust Day

In all four predictive models, there was a statistically significant negative time trend, meaning that if all other variables were to remain the same, utilization would decrease year after year. Among the first three estimates, there is indeed a slight decrease, but not as large as would be expected by the size of the regression slope coefficients. The explanation for the decrease being smaller than expected is that the thirty-year average weather used as the reference fluctuates from year to year. For the first estimate, the thirty-year average of the May-through-December PDSI's was 0.64 (for 1967-1996), which is the highest (wettest) value in eighty years. For the

Witness Responsible:

Dr. Edward L. Spitznagel

remaining three estimates it declined, becoming 0.59 for 1969-1998, 0.51 for 1970-1999, and 0.40 for 1974-2003. As a consequence, the decreasing use projected over time was offset by the precipitous change from 0.64 to 0.51 over just three years. That is, the increasing dryness of the "average weather" tended to make the projected utilization increase, while the negative slope of the year variable tended to make the projection decrease, and these two almost canceled each other to yield net projections that were nearly constant.

In the four years between the third and fourth projections, the change in average PDSI was only –0.0275 per year, which, while still negative, has a lesser effect in canceling out the time trend. In addition, the negative slope of the year variable was estimated to be much larger over the last seven years, approximately –3.29 GCD averaged over 12 months, than the –0.76 GCD averaged over 36 months from the three previous weather normalizations combined. Two factors could have contributed to this change. The first is that the Lexington region experienced a severe drought in the summer of 1999, which led to water conservation and continuing conservation promotion by Kentucky-American subsequent to that event. The second is that the number of customer bills increased from 78,217 in December of 1996 to 97,718 in December of 2003, a 25% increase in customer base. The majority of these were not due to acquisition of other water companies but to additional houses and apartments being built in the area. All new construction in this period would have been required to have the newer water-conserving fixtures, such as toilets that use 1.5 gallons per flush, less than half that used by older toilets.

In fact, an examination of utilization during the four non-weather sensitive months of

Witness Responsible:

Dr. Edward L. Spitznagel

January through April reveals that utilization during those months decreased at a rate of –2.77 GCD from 1997 to 2003. Therefore, it appears that the introduction of water conserving fixtures was the larger contributor to the decrease in utilization.

For commercial utilization, the four estimates were:

Oct1997-Sep1998:	1549.69 Gal / Cust Day (average from monthly and quarterly bills).
Jan2000-Dec2000:	1553.14 Gal / Cust Day
Dec2000-Nov2001:	1553.43 Gal / Cust Day
Dec2004-Nov2005:	1385.52 Gal / Cust Day

In the first three predictive models, a statistically significant time trend did not exist, meaning that if all other variables were to remain the same, utilization would remain the same year after year. Indeed, the first three estimates are virtually identical. In the fourth model, there was a statistically significant time trend of –22.05 GCD.

An examination of utilization during the four non-weather sensitive months of January through April reveals that utilization during those months decreased at a rate of –17.34GCD from 1997 to 2003. Therefore, as with the residential time trend, it appears that the introduction of water conserving fixtures was the larger contributor to the decrease in utilization.

b. For residential customers, the trend appears to be –3.29 GCD per year, assuming the 30-year average weather remains relatively constant. Of this, the greater part, –2.77 GCD per year (84%), appears to be due to the introduction of water-conserving appliances. Therefore, as long as home and apartment construction in the Lexington

Witness Responsible:

Dr. Edward L. Spitznagel

region continue at the current rate, the downward trend in utilization should continue at approximately –3 GCD per year.

For commercial customers, the trend appears to be –22.05 GCD per year, assuming the 30-year average weather remains relatively constant. Of this, the greater part, –17.34 GCD per year (79%), appears to be due to the introduction of water-conserving appliances. Therefore, as long as commercial construction in the Lexington region continues at the current rate, the downward trend in utilization should continue at approximately –20 GCD per year.

c. All other things being equal, a decrease in total demand would translate to a lower total cost of production and lower revenues and since many of Kentucky American Water's costs are fixed, higher rates to cover the variable and fixed costs of service.

Witness Responsible:

James E. Salser/Coleman D. Bush

50. Refer to the Direct Testimony of James E. Salser at 8-10. For each customer class in which Mr. Salser has made changes to reflect an increase in customers due to normal growth, provide the assumptions used to calculate the number of additional customers, show the calculations used to derive the change, and explain the reasoning for the change.

Response:

Kentucky American Water's customer base has grown consistently for the past several years at approximately 2,500 customers per year. For the residential class, we used a 3-year average of historical growth to project growth for the forecasted period. For the commercial class, we used a six-year average of historical growth to project growth for the forecasted period. Any growth in fire protection customers was based on recent growth history in these classifications.

Witness Responsible:

James Salser

51. Refer to Kentucky-American's Application, Exhibit 37, Schedule M. Provide a copy of this schedule in Excelâ 97 spreadsheet format.

Response:

See attached file KAW_R_PSCDR2#51_attachment_062804.xls.

Witness Responsible:

Coleman Bush

52. Provide a schedule that lists, by name and title, each of the 133 Kentucky-American employees included in the forecasted test period. Provide on the schedule, separately, the amounts forecasted to be paid to or on behalf of each individual for regular time and overtime, incentive pay plan, 401 K plan and any other labor expense included in forecasted labor costs. Then, show the forecasted allocation or direct assignment of payroll costs to each business unit of Kentucky-American for the forecasted test period. Then, detail on this schedule, the accounts to which each of those amounts are forecasted to be recorded (e.g., capital plant accounts, labor expense accounts, deferred asset accounts for security costs, condemnation case, other system acquisitions). This schedule shall include totals for all amounts listed. The schedule should include but not be limited to total forecasted labor of \$5,140,435, \$158,820, and \$44,408 for Central Division, Tri Village, and Elk Lake, respectively, in full detail.

Response:

See attached schedule. The 401K detail was included in the original filing. See workpapers 3-1 pages 31 through 34. For the electronic file see KAW_R_PSCDR1#1a_WP3_O&MEXPENSES_052004.pdf.

Witness Responsible:

Coleman Bush

53. Provide a schedule containing the information requested in Item 52 for all persons that Kentucky-American employed during the calendar year ending December 31, 2003.

Response:

See attached schedules. The detail for 2003 includes labor charged to Bluegrass Station, Boonesboro, and Pineville which was eliminated from the base year amounts in the rate filing. For the electronic files see KAW_R_PSCDR2#53_attachment1_062804.pdf for all labor information, KAW_R_PSCDR2#53_attachment2_062804.pdf for 401K information, and KAW_R_PSCDR2#53_attachment3_062804.pdf for incentive information.

Witness Responsible:

Michael A. Miller

54. Explain how Kentucky-American, when developing a forecasted test period, determines the appropriate accounting treatment (e.g., expensing, capitalizing, deferring as a regulatory asset) the forecasted payroll costs for an employee.

Response:

The Company utilizes the approved budget for each position adjusted for any known and measurable change in the amount of time that may have occurred since preparation of the budget. The budgets are prepared using the historical information regarding where positions have charged their time adjusted for the same known and measurable changes at the time of budget preparation.

Witness Responsible:

Michael A. Miller

55. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), Workpapers 3-8. Kentucky-American employee Linda Bridwell assisted in the preparation and filing of Kentucky-American's application for rate adjustment.

    a. State what portion, if any, of the historical labor costs attributable to her, that is included in regulatory expense listed.

    b. If no historical labor costs attributable to Ms. Bridwell are included in regulatory expenses, explain why none were included.

    c. If historical labor costs attributable to Ms. Bridwell are included in regulatory expenses, explain how Kentucky-American accounted for this occurrence when determining the cost of her labor for forecasted test period expenses.

Response:

a. None.

b. The Company's forecasted test-year includes the full salary for Ms. Bridwell. It would not be appropriate to also include a portion of Ms. Bridwell's salary from a prior period in the amount of rate case expense requested in this case to be amortized over three-years.

c. No historical labor expense for Ms. Bridwell is included in the forecasted period, only her full salary for the forecasted test-year.

Witness Responsible:

Chris E. Jarrett/Michael A. Miller

56. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), Workpapers 3-1. For each of the vacant personnel positions listed in forecasted labor costs, state:

    a. The reason(s) why the position must be filled.

    b. The reason(s) why the position is currently vacant.

    c. The current status of Kentucky-American's efforts to fill the position.

    d. The total cost of the position included in the forecasted test period (i.e. payroll expenses, payroll capitalized, retirement, taxes, insurance benefits) and the accounts to which each amount was charged.

Response:

a. By filling the Operations Engineer position, we can reduce our reliance on outside consultants; it is important to fill the vacant crew leader position in order to appropriately respond to maintenance needs; the meter reader is needed to reduce the number of estimated reads.

b. Normal turnover.

c. The Company is pursuing the filling of all vacant union positions. Many employees across the American Water System are currently applying for positions related to the reorganization. The Company does not plan to fill the Operations Engineer position until the American Water System completes its process of filling the positions related to the reorganization, which is expected to be completed in July of this year. This will permit Kentucky American Water to consider qualified engineers who may be available due to changes in other locations of American Water. Given the multitude of engineering experience within the American Water System, the Company believes this will result in obtaining the best available employee for Kentucky American

Witness Responsible:

Chris E. Jarrett/Michael A. Miller

Water. The Company plans to fill this position before the hearing in this case. If for any reason the position will not be filled, the Company will make the Commission and all other parties to this proceeding aware of that at or before the hearing.

d. The Operations Engineer is forecasted 100% to capital and other.

The crew leader is charged to 120105 501200 for $33,481 of O & M expense and $3,724 to capital and other.

The meter reader is charged to 120102 501200 for $52,186 of O & M expense and $234 to capital and other.

Payroll taxes are included at 8.95% of O & M labor and are included in accounts 685320 (FUTA), 685325 (FICA) and 685350 (SUTA). Workers Comp is included at 1.22% of O & M labor and is included in account 558000.16. Group Insurance is included at 18.40% of O & M labor and is included in account 504100.16. Pensions and OPEBs are included at 17.34% and 11.87%, respectively and are included in accounts 506100.16 and 505100.16, respectively. 401-K is included at 3.0% of O & M labor and is in account 507100.16

Witness Responsible:

Michael A. Miller

57. For Kentucky-American's forecasted incentive pay program:
    a. List all Kentucky-American employees who are eligible to participate in the program.
    b. State the level of incentive pay available to each participant in the forecasted period.
    c. State the level of incentive pay awarded to all individuals participating in the program for the previous 5 years compared to level of incentive pay available to each participant in the forecasted period.
    d. Explain how incentive payment awards in previous years were determined.
    e. State the amounts of incentive payment awards included in the forecasted test period.
    f. Explain how the amounts of incentive payment awards included in the forecasted test period were determined.

Response:

a. Mr. Mundy as President of the Company is eligible for the LIP. As stated in the response and attachment to AG1 question #123, all full-time management, professional, and technical employees (exempt from overtime) in American Water are eligible to participate in the 2004 AIP. See the response to section PSC2 question 52 above for the employees eligible for the AIP as so indicated by the next to last column on that schedule having an incentive pay amount.

b. Each eligible employee has a target incentive plan pay-out that assumes achieving 100% of the financial, customer service, and individual goals and objectives. The target is based on a percentage of the mid-point of the salary range for each employee and the percentage varies depending on the level and type of position. Based on the AIP guidelines, performance criteria, the financial projections for KAWC and the historical excellent customer service record of KAWC the Company developed the AIP costs included in the forecasted test-year. A detailed description of the AIP and

Witness Responsible:

Michael A. Miller

its administration is included as an attachment to the response to AG1 question #70. The LIP included in the forecasted test-year assumes Mr. Mundy meets the target at 22.5% of the mid-point of his salary.

c. Please see attached schedule KAW_R_PSCDR1#57_attachment_062804.pdf.

d. If the overall threshold was met, each individual participant's performance was reviewed regarding their accomplishments in meeting the financial, customer service and individual goals and objectives. From that review, the level of accomplishments in each category were determined and weighted by the plan performance matrix to determine the individual's award from the AIP.

e. Please see item 57 c above. Also see AG1 response to question 70.

f. See response to 57 b above.

Witness Responsible:

Chris E. Jarrett

58. Refer to the Direct Testimony of Coleman D. Bush at 8. Only 10 percent of Barbara Brown's and David Whitehouse's labor and other expenses are allocated to Kentucky-American because their involvement to the source of supply issue and condemnation proceeding that Lexington–Fayette Urban County Government ("LFUCG") has brought allow them "almost no time available to devote to Kentucky American Water's other businesses." Explain why, as Roy Mundy has been directed by Kentucky-American's Board of Directors to "devote his full time and energies to defending the Company" against the same condemnation proceeding,[1] the same ratemaking treatment has not been proposed for Mr. Mundy's labor and other expense.

Response:

As indicated in several responses to LFCDR1, notably items 52, 55 and 57, Mr. Mundy is continuing in his responsibilities for the day-to-day operation of all of Kentucky American Water's businesses in addition to his increased efforts in the condemnation proceeding.

1 Direct Testimony of Chris E. Jarrett at 5 - 6.

Witness Responsible:

Michael A. Miller

59. Refer to the Direct Testimony of Michael M. Miller at 27, lines 2-3. Identify all expenses related to the LFUCG condemnation proceeding that Kentucky-American has included in the forecasted test period rate base and expenses.

Response:

None.

Witness Responsible:

Coleman D. Bush

60. In Exhibit 1 of his Direct Testimony, Coleman Bush details the allocation of costs common to Kentucky-American's regulated and non-regulated business units.

    a. Explain how this allocation is reflected in Exhibit 37, Schedule C2, of Kentucky-American's Application.

    b. Show the detailed calculations used to derive each component of the total Labor Direct and Common costs allocated of $1,227,364.

Response:

a. The allocation is reflected in the adjustment column on Schedule C2.

b. Office Cost – see attached file KAW_R_PSCDR2#60_attachment_062804.pdf.

   O&M Labor – O&M labor included in the case, except that for Barbara Brown and David Whitehouse, the O&M labor for allocation has been reduced to 10% of the total O&M labor.

   PIT (Pension, Insurance and Taxes) is applied at 54.45% of O&M labor.

   Incentive Plan is applied at 8.81% of O&M labor.

Witness Responsible:

Michael A. Miller

61. Refer to the Direct Testimony of Michael M. Miller at 62-63. Mr. Miller testifies that to avoid "rate shock" Kentucky-American proposes to allocate only one-third of the identifiable costs to its Northern Division districts.

    a. State the effect on the Northern Division's proposed rates if all identified costs are allocated to the Northern Division District. Provide all workpapers, state all assumptions, and show all calculations used to identify the rate impact.

    b. Explain why the allocation of the Northern Division's costs to the Central Division is fair and reasonable to the Central Division's customers.

    c. Explain why Kentucky-American did not propose a uniform tariff for all customers in this proceeding rather than announce its intention to seek such a tariff in its next rate case proceeding.

    d. Describe the effect on Kentucky-American's proposed rates if a uniform tariff for both divisions were used in this proceeding. Provide all workpapers, state all assumptions, and show all calculations used to calculate the effects of a uniform tariff.

Response:

a. If the amount of unallocated common expenses of $86,341 were fully allocated to the operations Northern Division (Tri-Village and Elk Lake) the rate increases for each district would be as follows:

	Revenue Increase	Add'l Revenue if Fully Allocated	Fully Allocated Revenue Increase	Going Level Revenues
Tri-Village	338,208	73,280	411,488	825,059
Elk Lake	39,325	13,061	52,386	93,248
		86,341		

Witness Responsible:

Michael A. Miller

	Proposed	Full Allocation
Tri-Village	40.99%	49.87%
Elk Lake	42.17%	56.18%

b. See the testimony of Michael A. Miller, pages 62 and 63, which explains the Company's basis and justification for its proposal not to fully allocate common costs to the Northern Division tariffs.

c. The Company's corporate expenses did not increase from the acquisition of the Northern Division and the existing rates of the Central Division were established to recover all of those costs. Because other cost of service elements in the Northern Division required a significant increase in rates the Company applied the regulatory principle of gradualism in its proposal to allocate a portion of the common corporate costs to the Northern Division to avoid a higher rate than that proposed by the Company in this case. The $86,341 unallocated cost has only a minor impact on the Central Divisions customers. The Company believes its desire to propose a single tariff in its next rate case can eliminate this issue going forward.

d. The Company has not prepared the necessary cost of service studies at this time to fully answer this question, but plans to do so before filing its next rate case.

Witness Responsible:

Coleman D. Bush

62. a. State whether any of the field employees listed in the 133 forecasted personnel positions provide services to Kentucky-American's non-regulated operations.

    b. For each field employee who provides services to Kentucky-American's non-regulated operations, describe how the employee's time is assigned or allocated to those operations.

Response:

Please refer to the response to LFCDR1#50.

Witness Responsible:

Coleman D. Bush

63. Provide, using the same format as found in Kentucky-American's Application, Exhibit 37, Schedule C-2, a fully disclosed forecasted income statement that details separately revenues and expenses of all non-regulated activities and calculation of net income.

Response:

The Company does not prepare financial statements for its non-regulated businesses in a regulated format. Included in attached file KAW_R_PSCDR2#63_attachment_062804.pdf are recent management reports for the non-regulated businesses. In addition to the expenses included in these statements, in the forecasted test year, the Company is proposing an additional allocation of common and direct costs to Pineville and Bluegrass Station Division according to Exhibit 1 in Mr. Bush's testimony.

Witness Responsible:

Sheila Valentine

64. List, for each of Kentucky–American's 5 most recent applications for rate adjustments, the amount of rate case expense incurred and state whether Kentucky-American used a historical test period or future test period in its application.

Response:

The 5 most recent rate filings have been based on a future test period.

Case No. 2000-120	$459,817
Case No. 97-034	$326,414
Case No. 95-554	$389,982
Case No. 94-197	$250,434
Case No. 92-452	$437,125

Witness Responsible:

Michael A. Miller

65. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), Workpapers 3-8. State whether, in Kentucky-American's opinion, the stated rate case expense of $622,409 would be less if the application was based upon an historical test period. Explain.

Response:

The Company has not filed an historical test-year rate case since the early 1990's. The Company has prepared no study or analysis on which to base an opinion on this issue. The Company does not know for sure if it would save costs, that would depend on the issues in a case, the number of outside witnesses needed to address those issues and the level of discovery requests issued in the case. The Company has not filed a rate case since 2000 and there are a great many issues in this case that have developed over that time such as, the shared services center, call center, security and the acquisition of the Northern Division operations that are big drivers of the estimated cost of this case. In addition, there appears to be a good deal of discovery on the part of the interveners, at least in the Company's view, that is related to issues not relevant to the setting of rates by the Commission in this case.

One benefit that has come from the use of a forecasted test-year is less frequency of filings. The Company has been able to extend the time between rate filings since it went to a forecasted test-year filing and that is important to the Company as we would think it would be to the Staff and Interveners in this case. The Company would not want the return to historical test-year filings to put the Company in the position of having to file annual rate cases. Annual rate cases, even if they were smaller rate increases, could be less attractive to our customers.

Witness Responsible:

Michael A. Miller

Between the conclusion of this case and before the Company files its next rate case, the Company intends to fully analyze this issue and would be willing to discuss it with stakeholders. The Company believes the filing of a historical test-year case could meet its objectives if it had some assurance that post-test year construction and known and measurable changes to expenses and other cost of service elements could be dealt with equitably. In addition, the Company would like to discuss single tariff pricing and Distribution System Improvement Surcharges (DSIC) that possibly could be incorporated to lessen the chances for annual rate filings. One other issue that could be discussed in these meeting is the approval of rate increases for specific large construction projects that would be addressed in the certificate cases required for those types of projects. Future projects dealing with the supply shortage or additional treatment capacity would fall into this category, and there could be others. The project step rates concept has been proposed and applied successfully in other jurisdictions.

Witness Responsible:

Michael A. Miller/Sheila Valentine

66. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), Workpapers 3-8. State the amount of the rate case expense of $622,409 that may be attributed to the budgeting process necessary to develop the forecasted test period.

Response:

The Company has performed no studies or tracked its rate case preparation and processing expenses that would permit the Company to state the level of rate case expense that can be solely attributed to the budget process and the use of a forecasted test year. Please see response to question 65 above.

Witness Responsible:

Michael A. Miller

67. a. State and quantify the benefits to Kentucky-American ratepayers from Kentucky-American's use of a forecasted test period in this case and all previous forecasted test period rate cases. State all assumptions and show all calculations used to derive the quantification of benefits.

b. State and quantify the benefits to Kentucky-American shareholders from Kentucky-American's use of a forecasted test period in this case and all previous forecasted test period rate cases. State all assumptions and show all calculations used to derive the quantification of benefits.

Response:

a. The Company has performed no studies on which to quantify the benefits of KAWC's use of a forecasted test-year in its rate case filings. Please see response to PSC2, question #65 above. The Company does believe that the use of a forecasted test-year has contributed to the Company being able to avoid annual rate filings, which the Company considers a benefit to the ratepayers.

b. The Company has performed no studies on which to quantify the benefits to the shareholders of KAWC from the use of a forecasted test-year in its rate filings. The Company has not achieved it ROE authorized in case 2000-120 in any year since the issuance of the order in that case.

Witness Responsible:

Michael A. Miller

68. Describe the actions that Kentucky-American has taken to ensure that the most cost effective and economical approaches to rate application filings are used.

Response:

The Company has performed no study in this area, however, the Company files its rate case in compliance with the regulations of the Kentucky PSC and utilizes the in-house resources of KAWC, and American Water Works Service Company both of which have considerable experience in the area of rates and regulation. The Company believes that the use of the in-house rate employees and KAWC employees for most of its rate issues has proven to be both efficient and cost effective in processing rate filings. The Company attempts to limit outside witnesses to issues requiring specific expertise. The expert cost of capital witness in this case is very reasonably priced when compared to the cost of other cost of capital witnesses, as is the cost for the expertise required to support the weather normalization of revenues in the filing. There are a number of issues in this case for which the Company believed additional expert witnesses were necessary and that has had an impact on the estimated cost of this case. The Company also believes forecasted test-years have permitted the Company to avoid annual rate filings and maximize the time period between rate cases. The Company requests that the cost of rate filings be amortized over a number of years (three years in this case) which minimizes the cost of the rate filings embedded in rates. Please also see response to question #65 above.

Witness Responsible:

Michael A. Miller

69. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), Workpapers 3-8 at 1. Provide for each component of "Cost of preparation and presentation of current case":

a. The names of the persons providing services and a description of those services.
b. The hourly rate charged by each person.
c. The initial budgeted time of each individual to complete the application process.
d. The actual time and amounts billed by each individual to date.
e. The amount of time estimated to finish the rate application process by each individual.

Response:

a. See Notes Below	b.	c.	d.
Dr. James Vander Weide	Contract Price $25,000	Contract Price $25,000	No Bill Received
Dr. Edward Spitznagel	Contract Price $16,000	Contract Price $16,000	No Bill Received
Patrick Baryenbruch	$200	100 Hours	115 Hours $23,000
Kenneth Rubin	$350	$15,000	86 Hours $30,100
Coleman Bush	$75	Not in initial budget	290.5 Hours $21,788
James Salser	$100	700 Hours	874 Hours $87,400

Notes:

Each of the individuals listed above have described their services in their Direct Testimonies filed in this case.

Response to part e of this data request – Depends on additional discovery required plus the amount of time required to prepare and present the case before the Commission.

Witness Responsible:

Michael Miller

70. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), Workpapers 3-8 at 2. Provide for each individual listed:

    a. The complete name of the individual providing the service(s) and a description of those services.
    b. The hourly rate charged.
    c. The initial budgeted time to complete the application process.
    d. The individual's actual time and amounts billed to date.
    e. The individual's estimate of the amount of time to complete his or her portion of the rate application process.

Response:

The table reflects the answers to parts: (a), (b) and (d). See footnotes below the table for the Company's responses to subparts (c) and (e).

(a)	(a)	(b)	(d)
Michael Miller	Policy and review of each element of the Rate Filing	$64.655	198 Hours $19,049
Roy Ferrell	Rate Base, Bill Analysis, O&M items, Payroll and multiple allocators per 1971 Service Company Contract required by the PSC for comparing to the 1989 contract	$53.209	230 Hours $18,210
Sheila Valentine	Senior Financial Analyst in Charge of Preparing the case	$40.445	326 Hours $19,619
Tom Bailey	Federal Income Tax	$48.994	10 Hours $729

Witness Responsible:

Crystal Sanders	Federal Income Tax and Taxes Other	$30.794	12 Hours $550
Robert Shiltz	Formatting Electronic Filing	$33.525	224 Hours $11,174
Patti Hedrick	Secretary to Michael A. Miller	$17.648	226 Hours $5,935
Edward Oxley	Deferred Income Tax and Deferred Items	$36.949	78 Hours $4,288
James Bozman	Labor and preparing multiple allocators under 1971 contract		35 Hours $2,598
Ralph Jordan	Bill Analysis and Detailed Service Company		142 Hours $5,029
Linda Gutowski	Bill Analysis, Uncollectible expense, and revenue taxes		118 Hours $7,337
Basil D'Antonio	Supervised Payroll and Bill Analysis		18 Hours $1,870
Lori O'Malley	Payroll and miscellaneous expenses		35 Hours $2,270
Coleman Bush	Areas covered in his Direct Testimony		36 Hours $3,373

Notes:

(c) The estimated Service Company time and expenses was based on actual cost incurred in prior KAWC rate filings—not individuals.

(e) Depends on additional discovery required plus the amount of time required to prepare and present the case before the Commission.

Witness Responsible:

Michael A. Miller

71. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), Workpapers 3-8 at 2.
    a. Explain the category "Shared Services."
    b. Provide a detailed analysis of the amount reported as "Shared Services."
    c. Explain how the Overhead ratio of 1.56 was calculated, state all assumptions, and show the calculations.

Response:

a. This refers to the Shared Services Center, an office of American Water Works Service Co., operation located in Marlton, New Jersey. Mr. Miller describes the services provided by the Shared Service Center in some depth in his testimony at pages 19-22.

b. Within the Shared Services Center there is a department that assists the operating companies in obtaining and verifying the historical data utilized in preparing rate cases. This department is staffed with employees that are knowledgeable in the JDE and ORCOM software applications and have experience and expertise in preparing rate filings. This group obtains and verifies much of the historical data from the accounting and billing systems, including General Ledger account downloads and bill analysis data, and provides that information to the local rate departments that prepare the rate filings. The Company has found that utilizing this shared rate group permits the Company to share resources and expertise to all the operating companies preparing rate cases in the various states more cost effectively than maintaining those employees locally where rate cases may only be prepared once in a number of years. This group in addition assists in preparing the interrogatories involved with the various rate cases. They can utilize information on such items as pensions, group insurance, service company billings, insurance other and other items that are common

Witness Responsible:

Michael A. Miller

to all the operating subsidiaries of American Water and may have already been prepared for other rate cases which provides consistency in rate case information and saves costs. The Company believes this arrangement is cost effective and efficient. In fact, it would have been very difficult, if not impossible, for the Company to respond to the extensive level of interrogatories in this case over the last two weeks without that assistance.

The Company did not prepare a detailed estimate of the $15,000 for utilizing the Shared Service Center rate staff, but based its estimate on its experience in several on-going rate cases or just completed rate case with which the SE Region rate staff has recently been involved with in other jurisdictions.

c. The 1.56% overhead rate is the effective rates for pensions, group insurance, workmen's compensation insurance, 401(k), and payroll taxes as a percentage of payroll charged to the rate case expense of the Service Company employees working on this case. See below for the component breakdown.

Pensions –	19.75%	
Workmen's Compensation-	1.19%	
Group Insurance –	16.99%	
OPEB's –	12.69%	
Transportation –	5.79%	
Total	56.41%	The Company used a rounded 56% for its estimate.

Witness Responsible:

Michael A. Miller

72. Explain why Kentucky-American proposes a 3-year amortization period for rate case expenses.

Response:

In this case the Company is requesting a three-year amortization of its forecasted rate case expense. The Company has requested a three-year amortization of rate case expense because that time frame appropriately reflects the historical period between general rate filings for the Company.

Witness Responsible:

Michael A. Miller

73. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), Workpapers 3-8

    a. State when Kentucky-American last contracted out to independent consultants the services listed in Workpapers 3-8.

    b. Provide for each services listed in Workpapers 3-8 that were provided by independent consultants Kentucky-American's request for proposals and all bids received in response.

Response:

a. (1) Rate of Return Consultant – Consultant was used in KAWC's last general rate filing

   (2) Security Consultant – Not an issue in prior cases

   (3) Service Company Consultant – Not used in prior cases

   (4) Weather Normalization – Same Consultant used in prior KAWC last rate filing.

   (5) Consultant for Rate Filing – Edward Grubb had prepared and filed all previous forecasted electronic rate filings. Mr. Grubb has been transferred to another Company within the American System. Mr. Jim Salser , a former Director of Rates within the American System, who had prior experience with the electronic filing in Kentucky, was retained to assist in filing this case.

b. The Company did not solicit bids for consultants used in this case. With two exceptions, the Consultants used in this case have been used in recent cases involving other states assigned to the Southern Region of American Water Service Company. The two exceptions are: (1) Rate of Return Consultant – the Contract Price is very close to the consultant used in the prior KAWC rate filing and (2) Security Consultant – new issued being addressed by KAWC.

Witness Responsible:

Michael A. Miller

74. a. Provide a current organizational chart for American Water Works Company ("AWWC") that includes all subsidiaries and service companies and depicts how each relate to another as far as services and functions provided.

    b. Describe how AWWC's subsidiaries and service companies determine charges and billings for each service or function provided.

Response:

a. Please see response and attachment to question AG1 question #81.

b. Each employee prepares time sheets that either directly charges a specific subsidiary for which they are providing services or, when they are performing work on behalf of the total company, the regulated subsidiaries or the companies within their assigned region they charge their time to a formula established to appropriately allocate those charges. A further description of the methods of charging time can be found in the Service Company Contract.

Witness Responsible:

Michael A. Miller

75. State whether AWWC is currently undertaking a restructuring process with the ultimate goal of reducing its workforce.

Response:

Please see responses LFUCG questions #16, #17, #18, #19, and #20.

Witness Responsible:

Michael A. Miller

76. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1 (a), Workpapers 1-12 at 2.

    a. Provide a detailed analysis of the amounts accrued by Kentucky – American totaling $629,839.84 for the Customer Care Center in Alton, Illinois.

    b. Provide a detailed calculation of the Customer Case Center amortization expense of $8,900.

    c. Provide a detailed analysis of the amounts accrued by Kentucky – American totaling $704,179.34 for the National Shared Services Center in Marlton New Jersey.

    d. Provide a detailed calculation of the National Shared Services Center amortization expense of $13,417.

Response:

a. Please see attached document KAW_PSCDR2#76_attachment1_062804.pdf.

b. Please see attached document KAW_PSCDR2#76_attachment2_062804.pdf.

c. Please see attached document KAW_PSCDR2#76_attachment3_062804.pdf.

d. Please see attached document KAW_PSCDR2#76_attachment4_062804.pdf.

Witness Responsible:

Michael A. Miller

77. At page 23 of his Direct Testimony, Michael M. Miller testifies regarding the deferral of costs related to the Customer Care Center and National Shared Services Center that "I have also reviewed rate filings and Orders of all other American Water regulated subsidiaries and know of no other jurisdiction that has denied similar prudently incurred and cost justified expenditures for rate recovery." Provide a copy of the Orders to which Mr. Miller refers.

Response:

Those orders can be found on the web sites of the various regulatory commissions under the case numbers mentioned below. All of the orders in the cases below were not determined in a fully litigated rate case, but some were resolved by settlement of the parties. In some cases the settlement was to the overall revenue requirement and do not detail the cost of service elements that make up that requirement. Mr. Miller's statement above is based on his knowledge of those rate cases obtained through review of some orders, and through internal communications (primarily verbal) with the other VP/Treasurers and Directors of Rates in the American Water System. After preparing the testimony Mr. Miller has learned of one case where the PUC of California did not fully recognize the Call Center and Shared Services Center transition costs. In that case, which was only for the Monterey District, the Commission did not recognize the transition costs allocated to that District. The California PUC did indicate in their Order that the current rates of the other Districts of California-American did have rates set not reflecting the savings from the move to the Call Center and Shared Services Center, therefore to the extent the Company was amortizing the transition costs equal to the savings the transition costs were included in current rates. In all other cases listed below the transition cost to the Call Center and Shared Services were included in the cost of service and tariffs approved.

Witness Responsible:

Michael A. Miller

Mr. Miller has been directly involved and a witness sponsoring the rate making requests regarding the Call Center and Shared Services in the following rates cases:

Virginia-American – Case No. - PUE-2002-00375 and PUE-2003-00539
Tennessee-American – Case No. – 03-00118
West Virginia-American – Case No. – 01-0326-W-42T and 03-0353-W-42T

Please refer to the case numbers below for other jurisdictions:

New Jersey-American – Case No. WR-03070511
Missouri-American - Case No. WR-2003-0500
New Mexico-American - Case No. 03-00206
Pennsylvania-American – Docket No. R-00038304
Illinois-American – Docket No. 02-0690
Indiana-American – Cause No. 42029
California-American – Decision D03-02-030

Witness Responsible:

Michael A. Miller

78. Refer to the Direct Testimony of Michael M. Miller, Exhibit MAM-5 at 3 and 5. Provide the account numbers for the listed expense accounts where savings are shown and describe how the amounts were determined. Show all calculations and state all assumptions used to determined the amount of savings.

Response:

Please see updated schedule of Exhibit MAM-5, page 3 of 5 attached as KAW_R _PSCDR2#78_attachment_062804 that now includes the account numbers. The numbers on the schedule are a recap of the expenses approved in the last rate case compared to those in the current rate case. The savings are determined by the mathematical determination of the difference. The actual savings are likely higher since the 2000-120 approved expenses have not been adjusted for inflation.

Witness Responsible:

Michael A. Miller

79. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), Workpapers 4-1 at 7.

a. Reconcile the amount shown as amortization of $703,518 to the expense at Kentucky-American's Application, Exhibit 37, Schedule C-2, page 1, of $695,154.

b. Explain the entry "Pineville Acq."

c. Explain why the amortization expense for Boonesboro is stated at $1,104 monthly while it appears as $1,087.57 at Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), Workpapers 1-12, Page 1.

Response:

a. The amortization of the Tri-Village ($ 5,676) and Elk Lake ($ 2,688) was inadvertently omitted from schedule D.

b. Start up cost related to Pineville O & M agreement. This should be omitted from Workpaper 4-1, Page 7 of 16.

c. The Boonesboro monthly amortization of $ 1,104 for the water and sewer acquisition costs. On the Workpaper 1-12, Page 1 the $ 1,087.57 is related to only water.

Witness Responsible:

Coleman D. Bush/Sheila Valentine

80. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), Workpapers 3-5 and the Direct Testimony of Coleman D. Bush, Exhibit 1. Provide a reconciliation of the management fees listed on the two schedules.

Response:

Total management fees expense was updated for the filing after Exhibit 1 in the Direct Testimony of Coleman D. Bush was prepared.

The impact of this change on the allocations out of the Central Division is:
An additional $1,471 for Tri-Village
An additional $262 for Elk Lake
An additional $27 for Bluegrass Station Division

Witness Responsible:

Coleman D. Bush

81. State whether any of Kentucky-American's non-regulated business units receives services from any of the related parties whose charges to Kentucky-American are included in management fees. If yes, describe the service(s) received and how their costs are allocated or assigned to those non-regulated activities.

Response:

None of the related parties charge directly to our non-regulated businesses. However, we have allocated some management fees to Bluegrass Station Division a shown on schedule KAW_DT_CDB_EX1_043004 in my direct testimony.

Witness Responsible:

Michael A. Miller

82. a. Provide a detailed analysis of the amounts recorded as acquisition adjustments for Tri-Village Water District and Elk Lake.

c. For each acquisition, demonstrate that:

(1) The purchase price was established through arms-length negotiations.

(2) The Initial investment plus the cost of restoring the facilities to required standards will not adversely impact the overall costs and rates of Kentucky-American's existing and new customers.

(3) Operational economies were achieved through the acquisition.

(4) The purchase price of utility and non-utility property can be clearly identified.

(5) The purchase will result in overall benefits in the financial and service aspects of Kentucky-American's operations.

Response:

a. Please see the journal entries recording the two transactions on the attachment file KAW_PSCDR2#82_attachment_062804.pdf accompanying this response.

c. (1) The transactions were developed through negotiations with the Tri-Village Water District Board and the Elk Lake Homeowners Association. The negotiations consisted of numerous meetings where proposals and comments were exchanged leading to the Purchase Agreements signed by all parties.

(2) The Company has maintained separate tariffs for the Tri-Village and Elk Lake operations. The Company has utilized its Central Division employees to address service issues in the Northern Division, charging their time directly to the Northern Division and reflected those charges to the Northern Division in the rate filing. In addition, the Company has allocated a portion of its corporate expenses to the Northern Division operations in its rate request.

Witness Responsible:

Michael A. Miller

Current rates include the full allocation of the Central Division employees of which a portion is being requested to be covered by Northern Division customers in this filing. The acquisition permitted KAWC to spread certain fixed costs over a larger customer base benefiting its existing customers. The Central Division customers benefit from those labor charges that were previously fully embedded in the rates of the Central Division and are now borne by the customers of the Northern Division. The Central Division rates approved in this case will be lower than they would have been had the acquisitions not occurred.

(3) Please see response to part 2 above. The Northern Division also received the benefits of KAWC expertise in water quality, distribution system operations, engineering, and management that permitted correction of water quality and service issues in a cost effective manner. The Northern Division did not possess that expertise before the acquisition by KAWC and did not attempt to attract that expertise or could not obtain that expertise in a cost effective manner.

(4) Please see response and attachment to section a of this response.

(5) See responses to sections 2 and 3 above. The Company has clearly demonstrated that its customers in both Divisions have benefited from the acquisitions. The Central Division customers benefit from the spreading the fixed costs embedded in current rates to the larger customer base and the economies of scale afforded by the larger customer base. The Northern Division customers have benefited from the expertise and capital of KAWC to address the water quality and service issues at the Northern Division that was not being addressed or planned to be addressed without the involvement of KAWC.

Witness Responsible:

Michael A. Miller

83. Identify the proceedings in which the Public Service Commission of Kentucky allowed rate base treatment for unamortized rate case expenses as Kentucky-American requests.

Response:

The Company does not know of any proceeding where the PSC of Kentucky has permitted rate base treatment for the unamortized portion of rate case expense. In past cases where KAWC was filing annual rate cases the rate case expense was amortized over one year and it would not have been applicable to obtain a return on the cost to file and process the rate case. In this case the Company is requesting a three-year amortization of its forecasted rate case expense. The Company has requested a three-year amortization of rate case expense because that time frame appropriately reflects the historical period between general rate filings for the Company. The Company believes it would be appropriate and justifiable for the Commission to recognize a return on the unamortized cost of deferred rate case given the circumstances just described.

Witness Responsible:

Michael A. Miller

84. Identify the pertinent sections of the Orders of the Public Service Commission of Kentucky in which approval of rate base treatment for the Deferred Legal Settlement Costs addressed in Case Number 2000-00120[2] was granted.

Response:

Please see response to AG1 question #66.

Witness Responsible:

Dr. Kenneth I. Rubin

85. Refer to the Direct Testimony of Dr. Kenneth I. Rubin's at 15.
    a. Identify the three locations that Kentucky-American secured with Lexington off-duty police officers.
    b. State whether the locations listed in Item 86(a) were the same locations that Alliance Staffing secured?
    c. Identify all other locations that Alliance Staffing personnel secured?
    d. Describe the actions that Kentucky-American took to replace Alliance Staffing personnel and
    services when its contract with Alliance Staffing ended on August 19, 2003
    e. Provide the amounts, expense accounts charged, and vendor providing the security services at these three or any other locations as included in the forecasted test period.

Response:

a. The three locations were: Lock and Dam Number 9 on the Kentucky River, the Kentucky River Station (Water Treatment Plant), and the Richmond Road Station (Water Treatment Plant).
b. I will assume that the question refers to the locations in 85(a), in which case the answer is yes. Alliance Staffing simply took over from Kentucky American Water, the responsibility for organizing and supplying off-duty policy officers.
c. None
d. Kentucky American Water retained guard services from Murray Guard.
e. Costs for guard services are provided in KR Schedule 3, lines 38, 39, and 40.

Witness Responsible:

Michael A. Miller/Sheila Valentine/Richard Svindland

86. Refer to the Direct Testimony of Michael M. Miller at 30, Line 7.
    a. Provide a detailed analysis of the $143,194 included in forecasted test year expenses for "on-going security expenses."
    b. Provide the expense accounts and amounts charged during the forecasted test period for "on-going security expenses."
    c. List all capital costs related to "Security Costs" that are included in forecasted test year depreciation expense.
    d. State whether all related capital costs have been accrued to Security Costs – Deferred Debit.

Response:

a. While Mr. Miller's testimony indicates on-going security of $143,194, the Company included $134,412 in account 575711.16 for its forecasted test-year as demonstrated on Workpaper W/P-3-13, page 3 of 7. See the attached schedule that provides the Company's determination of ongoing expenses for security guards and other incidental expenses based on a three month average of current on-going security expense levels.

b. Please see response to section (a) above and schedule W/P-3-13, page 3 of 7.

c. Only the $992,842.30 of capital improvements for security enhancement charged to utility plant are included in the depreciation calculation for the forecasted test-year. Please see schedule attached to the response to question PSCDR2 #88 (a) below The $2.805 million deferred debit-security cost related to non-capital (non-utility plant) costs are not included in the depreciation calculations. The Company is requesting a 10-year amortization of the deferred debit-security cost with the unamortized cost in rate base.

d. No.

Witness Responsible:

Dr. Kenneth I. Rubin

87. Refer to the Direct Testimony of Dr. Kenneth I. Rubin at 16, Lines 5-11.

a. List all sources in addition to Jackie Howard on which Dr. Rubin relies for the proposition that "65-70 percent overhead for temporary W-2 employees is common in the industry and covers the cost of scheduling, management, liability insurance, statutory benefits, and a 10-15 percent profit."

b. Describe the research that Dr. Rubin has conducted to support the proposition that "65-70 percent overhead for temporary W-2 employees is common in the industry and covers the cost of scheduling, management, liability insurance, statutory benefits, and a 10-15 percent profit."

c. List all sources on which Dr. Rubin relies for the proposition that "in the professional services industry, of which consulting is a part, this level of overhead [65-70 percent] is considered reasonable."

d. Alliance Staffing provided the services of off-duty police from the City of Lexington. There are no other sources of this service.

Response:

a. As the testimony of Dr. Rubin indicates, this information was supplied directly by Jackie Howard. There were no additional sources.

b. As his testimony indicates, Dr. Rubin is quoting Jackie Howard in this sentence and conducted no further research.

c. Dr. Rubin has more than 20 years experience in the consulting industry, including starting and running his own firm for 11 years, and running an infrastructure consulting business within a global consulting firm for the last seven years. His remarks are based on his own experience setting and managing to overhead budgets as well as observing the budgets of dozens of companies with which Dr. Rubin has worked either as a prime contractor or subcontractor in consortium. He is thoroughly

Witness Responsible:

Dr. Kenneth I. Rubin

familiar with the overhead structure of the professional consulting industry.

d. Provide the estimates or bid solicitation responses that Kentucky-American received from other providers for the services that Alliance Staffing provided from April 1, 2002 to August 19, 2003. If Kentucky-American did not receive any estimates or bid solicitation responses, then explain why.

Witness Responsible:

Ken Rubin, Richard Svindland

88. Refer to the Direct Testimony of Dr. Kenneth I. Rubin at KR Schedule 2.

a. Provide the estimated useful life of the assets listed as Items 1 through 6 and 8 through 12.

b. Provide a detailed analysis and description of the costs included as Item 7, Security Office Building, in the amount of $7,445.26.

c. List the costs, if any, that are included on KR Schedule 2 and reflected in the forecasted test period depreciation expense. For each listed cost, state its original costs and the amount of annual depreciation expense included in the forecasted test year.

Response:

a. See attached file KAW_R_PSCDR2#88a_attachment_062804.pdf.

b. The total task order cost for Item 7 is $17,702.44. Of that total, $7,445.26 was spent prior to 9/11/01 and the remaining $10,257.18 after 9/11/01. Randy Walker Electric was the electrical contractor who ran conduits and pulled conductors. Dallman Systems was the Alarm Systems Integrator who installed and programmed the access control system and one security camera. The Excavator was a contractor used to bore under roadways in order to install conduits. Grott the Loc Doc was a vendor used to provide keyed locksets and McMaster Carr Supply was the vendor used to supply a new steel door. The following is a breakdown of the total cost for Item 7.

Witness Responsible:

Ken Rubin, Richard Svindland

Breakdown on Schedule 2 & 3 Item 7

Description	Amount	Comment
Contract Services & Materials	$15,502.96	Costs for Randy Walker Electric -$765.00, Dallman Systems -$8,568.52, The Excavator- $5,052.50, Grott the Loc Doc-$301.70 & McMaster Carr Supply-$815.24
Company Labor	$608.16	Company Labor to manage project.
Company Overhead	$859.05	Overhead on Co. Labor
AFUDC	$732.27	
Total	$17,702.44	

c. This information is provided in the attachment used for PSCDR2#88a. The depreciation rates are KAW's standard rates for the type of asset. The original cost is the same as the total cost and is the sum of the Pre 9/11 cost plus the post 9/11 costs.

Witness Responsible:

Ken Rubin, Richard Svindland

89. Refer to the Direct Testimony of Dr. Kenneth I. Rubin at KR Schedule 3.

    a. Provide a detailed analysis and description of the costs included as Item 7, Security Office Building, in the amount of $10,257.18.

    b. Provide the estimated useful life of the assets listed as Items 8 through 37, 43, 46 through 49, and 53 through 59.

    c. State whether "Porta Potty Rental," Item 41, is an annual recurring expense that is included in the forecasted test year.

    d. Provide a detailed analysis and description of the costs included as Item 42, "Securing Tanks," in the amount of $152,581.

    e. Provide a detailed analysis and description of the costs included as Item 44, "Clearing Fence Lines," in the amount of $6,230.55. Explain how this activity differs from routine fence clearing.

    f. Provide a detailed analysis and description of costs included as Item 45, KAW Labor, in the amount of $4,436.70.

    g. Provide a detailed analysis and description of the costs included as Item 50, "Survey work at Tank Sites," in the amount of $9,300.

    h. Provide a detailed analysis and description of the costs included as Item 52, "Communications Equip., Fees, and Misc.," in the amount of $194,665.41.

    i. Identify the costs included on KR Schedule 3, if any, that are reflected in the forecasted test period depreciation expense. For each identified cost, state its

Witness Responsible:

original costs, and the amount of annual depreciation expense included in the forecasted test year.

Response:

a. See response to PSCDR2#88b.

b. See file KAW_R_PSCDR2#88a_attachment_062804.pdf filed in response to PSCDR2#88.

c. No.

d. The worked generally involved the removal of all ladders from ground storage tanks, the raising of ladders on elevated storage tanks, the welding shut of all roof hatches, and modifications made to harden the tank vents and overflow pipes. A breakdown is below. During the preparation of this response, an error was found in the amount for item 42, thus item 42 should be reduced by $11,675.63. Item 52 will be increased by the $11,675.63 to correct the error. However, there is no impact on the total cost. The correction is just to re-categorize the expense to KR Schedule 3, item 52, miscellaneous.

Breakdown of KR Schedule 3 Item 42

Description	Amount	Comment
Big Auger Machine & Tool	$78,178.95	Secure CoxG, York, Hume, CM, PM, Clint, & Beck tanks. Fabricate parts for Duncan for other tanks.
Duncan Machinery Movers	$41,094.32	Secure BH, Tates, CoxE, Mercer, Hall, MF & Sadieville Tanks, includes installing parts fabricated by Big Auger.
D & D Machinery Movers	$21,382.10	Secure Montery, Bromley, Wheatley, Long Ridge, Hesler, Glencoe and Sparta tanks in Owen Co.
Error Amount	$11,675.63	
Old Total	152,851.00	
- Error amount	$11,675.63	
Revised Total	$140,905.37	

Witness Responsible:

e. This work was performed to remove brush and accumulated growth along the fence lines at Jacobson Reservoir and RRS. In the past, portions of fence line along the access road to Jacobson reservoir and along the backside of the RRS property next to the Lakeshore apartments were not cleared because the residents along those fence lines liked the privacy and preferred that we not remove any accumulated growth. After 9/11/01; however, KAW and the residents realized the importance of having a fence line that was cleared and easily available for inspection and did not object to us clearing the fence line. This fence cleaning has allowed us to make faster visual inspections of the fence to provide greater security for our property. Routine fence clearing is much more limited in scope and is usually done for aesthetic purposes.

Breakdown of KR Schedule 3 Item 44

Description	Amount	Comment
Creative Landscaping	$6,078.00	Labor cost for Creative Landscaping to remove brush from fence line around Jacobson Reservoir & RRS.
United Rentals	$152.55	Rental of shredder.
Total	$6,230.55	

f. Item 45 covers some of the labor costs charged to the Security account. The $4,436.70 amount is broken down as follows and covered labor cost to lock inactive accounts and supervise work on securing the tank sites.

Breakdown of KR Schedule 3 Item 45

Witness Responsible:

Description	Amount	Comment
Labor Burden	$815.35	
Ashby, Jeff W.	$329.44	12.5 OT hours at 1.5 base pay
Ashby, Jeff W.	$421.68	24 hours
Cruse, Robert M.	$105.42	6 hours
Payroll Labor Distribution	$2,764.81	122 hours of various employees
Total	$4,436.70	

g. Item 50 covers the cost to survey four sites (3 tank sites, one office building) that did not previously have perimeter fencing. CDP Engineers, Inc. provided the surveying service, which included field staking, verification of deed and/or easement and preparation of survey plats. Upon completion of this work the four sites were fenced. CDP's invoice for this service was $9,300.00

h. See attached file KAW_R_PSCDR2#89h_attachment_062804.pdf.

i. See response to PSCDR2#88a and the attachment to that response, file KAW_R_PSCDR2#88a_attachment_062804.pdf.

Witness Responsible:

Dr. Kenneth I. Rubin

90. Refer to the Direct Testimony of Dr. Kenneth I. Rubin at KR Schedules 2 and 3.

a. Included on Schedule 2 are "Pre 9/11" costs of security systems at the [redacted]

Identify the Security System costs listed on Schedule 3 for each of those locations, if any, were incurred to supplement or replace the system's costs included on Schedule 2. Explain.

b. Identify any assets or costs listed on these schedules that have been taken out of service or will be taken out of service prior to the end of the forecasted test period.

Response:

a. Security costs listed on Schedule 3 are all in addition to those costs listed on Schedule 2, with the only difference being the timing of these expenditures. Items 7-12 appear on both schedules since expenditures for these items were on-going prior to 9/11/01 and since projects were underway on that date, continued after 9-11-01.

b. There are none.

Witness Responsible:

Ken Rubin, Richard Svindland

91. Reconcile the amounts included in KR Schedules 2 and 3 of Dr. Rubin's Direct Testimony to the total Security Costs of $2,805,661.79 as shown at Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), Workpapers 1-12, Page 2.

Response:

KR Schedules 2 and 3 include both capitalized costs and deferred costs. The $2,805,661.79 as shown on Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), Workpapers 1-12, Page 2 includes deferred costs only. To reconcile, add items 38 through 52 on KR Schedule 3. These items add up to $2,731,262.57 and were current at the time of the rate case filing. The difference between the $2,805,661.79 and the $2,731,262.57 is the amount projected to be charged to this deferred account by November 2004. These charges are based on Murray Guard charges of approximately $11,201, per month.

Witness Responsible:

Linda Bridwell/Sheila Valentine

92. State the amount included in the forecasted test period for community education efforts toward conservation. State the expense account titles and numbers where this amount was recorded.

Response:

Kentucky American Water has included $146,000 for conservation efforts in each year for 2004 and 2005. These costs are split between Account 575030.16, Business Unit 120121 for advertising and Account 575000.16, Business Unit 120121 for other expenditures. The total balance in these accounts in the forecasted period is reflected on page 1 of 7 in W/P 3-13.

Witness Responsible:

Michael A. Miller

93. Refer to the Direct Testimony of Michael M. Miller at 48, lines 3-4. Identify the utilities whose incentive plans are in line with that of Kentucky-American and provide a copy or summary of each utility's incentive plan.

Response:

The Company has not performed a study in this area. The Company is generally aware that similar incentive plans are in place for many utilities as well as many other corporations. Also see response to AG1 question #80 that provides copies of the Management Audit Report pages that indicted the Company should pursue an incentive compensation plan as part of its overall compensation package.

Witness Responsible:

Michael A. Miller

94. Provide copies of any studies or analysis that Kentucky-American has performed that quantifies the benefits that the customers have received from the Incentive Plan.

Response:

The Company has not prepared a study or analysis in this area. The Company is attempting to obtain published studies or other information regarding industry and general business use of incentive plans and will supply that information once it is available. The Company believes the incentive plans provided to its employees contributes to the very high levels achieved in the customer satisfaction surveys. In the two latest surveys the Company has been recognized for excellent ratings, and was at the top of those satisfaction ratings when compared to other American Water Subsidiaries. The Company believes that the incentive plan provides motivation to its employees to perform at high levels and to always place customer service and satisfaction at the forefront of their efforts. The customers benefit from this highly motivated employee attention to customer service and having a portion of their compensation at risk for poor performance and poor customer service is one of the main motivators to the efficiency and high level of performance provided by the Company for the benefit of its customers. Mr. Miller fully describes the Company's position on this issue in his testimony and describes why the this expense should be recovered in rates on pages 47 through 54 of his testimony.

Witness Responsible:

Sheila Valentine

95. Refer to the Direct Testimony of Sheila A. Valentine at 6, lines 19-20. Provide detailed workpapers supporting the calculation of forecasted purchased water based on 2003 actual usage and appropriate costs.

Response:

Please see the attached schedule. For the electronic file see KAW_R_PSCDR2#95_attachment_062804.pdf.

Witness Responsible:

Sheila Valentine

96. Refer to the Direct Testimony of Sheila A. Valentine at 6, lines 27-30. Provide detailed workpapers supporting the calculation of forecasted system delivery of 14,463 million gallons based on the 5-year monthly history of pumpage and adjustments.

Response:

The Company does maintain a history of pumpage by month and in the past has used a 5-year average to allocate annual pumpage by month. For this forecast, we did not use that 5-year history, but rather used an allocation provided by our finance department based on budgeted monthly sales with additions for water not sold. For this forecast we did not prepare detailed workpapers using a 5-year history to allocate total annual pumpage to each month.

Witness Responsible:

Sheila Valentine

97. Refer to the Direct Testimony of Sheila A. Valentine at 6-7. Describe each adjustment that was made to the historical pumpage information that was based upon "judgment concerning future events."

Response:

There was no particular change in this forecast from recent years. In forecasting, we always consider the impact of any future events such as basin cleaning, treatment changes, pump maintenance, customer base changes, etc. that might impact how much water is pumped per station.

Witness Responsible:

Sheila Valentine

98. Refer to the Direct Testimony of Sheila A. Valentine at 7, Lines 8-16.

    a. List those chemicals where operational judgment was used in the development of the forecast. Explain how operational judgment was used in the development of the forecast. Show all calculations and state all assumptions used in the development of these forecasts.

    b. Provide the basis for the forecasted general price increase of 2.5 percent.

    c. Provide for each chemical listed in Workpapers 3-3 a 5-year analysis of the price changes that have occurred over the 5 years prior to the rate application filing.

Response:

a. To some extent, historical usage patterns and operational judgment are incorporated in the forecast for each chemical, whether the estimated chemical use per gallon treated changes or not. In particular, we have increased the use of the coagulant polyaluminum chloride over the recent years as we have seen the quality of the raw water in the Kentucky River decline with the recent cycle of increased rainfall. In our reservoir, we have forecast an increase in the use of copper sulfate and have changed the type of copper sulfate to improve the finished water quality concerning taste and odor. Except in cases where specific chemicals or chemical dosages are changed, chemical usage is forecast on the assumption that it will follow closely recent historical usage.

b. The 2004 contract prices were obtained at the end of 2003. Current knowledge of the increased price of chlorine, increased transportation costs, and inflation were all considered in determining the 2005 increase of 2.5%.

Witness Responsible:

Sheila Valentine

c.

Chemical	1999	2000	2001	2002	2003
Polyaluminum Chloride (PACL)	0.1417	0.1502	0.1044	0.1021	0.1038
Chlorine	0.1282	0.1288	0.139	0.1062	0.1717
Fluoride	0.2483	0.2612	0.2688	0.0925	0.0651
Carbon	0.3775	0.4653	0.4408	0.4658	0.4705
Copper Sulfate	0.6389	0.6082	0.6083	0.3300	0.8761
Polymer - 1	0.2165	0.1994	0.1767	0.1529	0.1506
Ammonia	0.1425	0.1406	0.1448	0.1591	0.1651
Caustic Soda (sodium hydroxide)	0.1291	0.0859	0.1345	0.1027	0.0746
Potassium Permanganate	1.2612	1.2592	1.3340	1.3520	1.3561
Polymer - 2	1.3710	1.1666	1.2287	0.9006	0.8211
Ferric Chloride	0.1100	0.1122	0.1261	0.1102	0.0556
Corrosion Inhibitor (zinc)	0.2263	0.2179	0.2073	0.2035	0.1781

Witness Responsible:

Sheila Valentine

99. Refer to the Direct Testimony of Sheila A. Valentine at 7 and Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), Workpapers 3-4.

a. Provide all bids for the forecasted cleaning of KRS and RRS.

b. State whether the forecasted cleaning of RRS is an annual expense. If it is not an annual expense, explain why Kentucky-American did not propose to amortize the forecasted amount.

c. State when cleaning of each station included in the forecasted amount will be completed.

d. Provide detailed workpapers supporting the monthly recurring expense of $3,500 for each station.

Response:

a. See attached bids or the electronic file KAW_R_PSCDR2#99_attachment_062804.pdf.
b. The forecasted cleaning for Richmond Road Station is not an annual cleaning. The Company did not propose an amortization because the cleaning was performed to eliminate the residuals that had accumulated from the winter months. Extreme flooding in the winter, with long periods of high turbidities, result in larger amounts of solids being removed from the water that is greater than the existing equipment can routinely process.
c. The cleaning of the Kentucky River Station will be completed by October 2004 and the process at the Richmond Road Station will be completed by the end of July 2004.
d. The expenses of $3,500 per month is based on historical operating costs. In preparation of the budget, one looks at historical operating costs, projected system delivery, and the average current cost per month. The last five years of annual costs are as follows:

Witness Responsible:

Sheila Valentine

	KRS	RRS
1999	28,650	22,896
2000	27,651	22,609
2001	30,412	32,603
2002	48,694	118,986 incl one time cleaning cost
2003	41,489	29,971

The expense for the Richmond Road Station should be in the amount of $2,500 per month when comparing to the historical operating costs. Thus, this amount has been overstated in the forecast by $12,000.

Witness Responsible:

Michael A. Miller/Sheila Valentine

100. Refer to the Direct Testimony of Sheila A. Valentine at 7 - 8.

a. State for each of the seven vacant positions listed in Workpapers 3-1 the amount included in Group Insurance.

b. Provide documentary evidence in the form of invoices or other statements of the 8.94 percent increase that is scheduled to become effective January 1, 2005.

c. Provide the OPEB analysis prepared by Towers Perrin to which Ms. Valentine refers. Also provide all workpapers resulting in an annual expense of $809,063. Include detailed workpapers that include all actuarial assumptions.

d. Explain why OPEB costs are not included in Workpapers 3-6?

e. At Kentucky-American's Application, Exhibit 37, Schedule C-2, page 1, the amount included as forecasted Group Insurance is $1,724,407. The amounts included in Ms. Valentine's testimony for OPEB's and in Workpapers 3-6 for insurance are $809,063 and 937,643, respectively, for a total expense of $1,746,706. Reconcile the amount included in Schedule C-2 with those included in Ms. Valentine's testimony and Workpapers 3-6.

f. (1) Provide the most recent historical actuarial study for OPEB's performed for Kentucky-American.

(2) Provide the workpapers for the most recent historical actuarial study.

(3) List all actuarial assumptions of this study.

(4) List and explain any differences in the actuarial assumptions in this study from those used in Towers Perrin's OPEB analysis.

Response:

a. There are three vacant positions listed in the Workpapers 3-1 which include vacancy 80 – Operations Engineer; vacancy 91 – crew leader; vacancy 94 – Meter reader with each

Witness Responsible:

Michael A. Miller/Sheila Valentine

b. listed as having 2,088 hours. The group insurance amount included for the three positions totals $14,051.

c. Corporate provided budgeting assumptions for 2005 which included a 12% increase for group insurance premium. This information was provided to Corporate by our actuaries. However some fixed cost components were not changed, resulting in an overall increase of 8.94% increase. See attached file KAW_R_PSCDR2#100_attachment_062804.pdf

d. Please refer to the electronic file KAW_R_AGKYDR1#75_attachment_062504.pdf This particular workpaper was inadvertently left out of the original filing. The worksheet is attached to the file referred to in item c. above.

e.

Schedule C-2 Group Insurance	1,724,407
Total OPEB	809,063
Total Group Insurance	937,643
Total OPEB & Group Insurance	1,746,706
Difference in Schedule C-2 and total in workpapers	(22,299)
OPEB's for Pineville & Bluegrass Station not included in filing	10,329
Group Insurance for Pineville & Bluegrass Station not included in filing	11,970
Net difference	0

f. The actuarial study for OPEB's is performed by Towers Perrin for the entire American System. Please see item c. above.

Witness Responsible:

Sheila Valentine

101. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), Workpapers 3-6. Provide all workpapers, show all calculations, and state all assumptions used to derive the capitalization rate of 19.53 percent.

Response:

Premium subtotal (see workpaper 3-6, page 1)	$1,268,347
Divide by Total Company Labor	6,494,455
Capitalization Rate	19.53%

Witness Responsible:

Michael A. Miller

102. Provide all studies and analyses that Kentucky-American has performed since the conclusion of Case No. 2000-00120 regarding the reasonableness and cost-effectiveness of its 1989 Service Company contract.

Response:

The Company has not performed a study, but in each case it must provide an analysis to the Staff between the management fees as allocated to the Company per the 1989 Service Company contract and the 1971 contract. That information is shown in the response to PSC1-#34. KAWC moved to monthly billing many years ago, which was one of the primary problems that lead to not approving the 1989 contract. When AWWSC moved to one allocation factor based on customers in the 1989 Service Company contract, some believed KAWC received an unfair amount of Service Company fees under the 1989 contract because they billed quarterly and customer billing costs allocated on customers was not fair to the customers of KAWC and those cost should have been allocated on bills. Now that KAWC bills monthly the variance in the allocated amounts under the 1989 contract and the 1971 contract are not material. In fact that variance as indicated on the schedule attached to the response to PSC1-#34 is now only $58,282

While the response to PSC1-#34 is summed up in one schedule it takes an enormous amount of time and effort to create the formulas under the 1971 contract and to then sort out the substantial individual Service Company charges and apply those multiple allocation factors to generate the schedule. American Water only has to perform those tasks when KAWC files a rate case. I believe that in the states where American Water operates regulated subsidiaries that require approval of affiliated agreements, Kentucky is the only state not to recognize the 1989 Service Company contract.

Witness Responsible:

Michael A. Miller

103. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), Workpaper 3-5 and Item 34. Provide a reconciliation of the management fees for the forecasted period contained on these schedules.

Response:

See the reconciliation below.

Reconciliation of management fees reported in response to Staff's First Request, Item #34 with the amount reported on Company's workpaper 3-5, page 1 of 2:

Total (Allocated) to a/c 923.1 per response to Staff's First Data Request, Item #34,page 2 of 5	$3,197,568
Total (Direct Charges) to a/c 923.1 per response to Staff's First Data Request, Item #34, page 3 of 5	602,009
Total Management Fees reported on response to Staff's First Data Request, Item #34	$3,799,577
Total Management Fees reported on workpaper 3-5, Page 1 of 2	$3,800,677
Difference	($ 1,100)

The small difference of $1,100 would be very labor intensive to identify, given the voluminous number of transactions used to generate the response to PSC1-#34.

Witness Responsible:

Michael A. Miller

104. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), Workpapers 3-7 at 2.

  a. Provide the actuarial study supporting the schedule at this page.

  b. Provide all workpapers, show all calculations and state all assumptions used in the actuarial study.

Response:

  a. The Company's latest actuarial reports for pensions were completed in 2003. A copy of that report is attached to the response to AG1-#77. The schedule attached to the Company's filing as W/P-3-7 at 2 is an updated estimate of FAS 87 pension expense for 2004 as provided by the firm of Towers Perrin, the actuary for the American Water pension plan. The full actuarial analysis for 2004 will not be completed and supplied to American Water until later this year. The Company relied on the latest information from Towers Perrin to determine the FAS 87 pension expense used in its forecasted test-year, the information found on W/P-3-7 at 2.

  b. All calculations and assumptions used in the 2003 actuarial report from Towers Perrin are included in the 2003 report attached to AG1-#77. The information shown on W/P-3-7 at 2 is determined based on the 2003 actuarial report updated to provide the most current estimate of 2004 FAS 87 costs, and the assumptions used and provided by Towers Perrin to generate the update are as follow.

Comments on Qualified Pension Plans

The net pension cost for the American Water pension plan reflects the merger of the St. Louis Plan.

Witness Responsible:

Michael A. Miller

The pension cost under FAS 87 for the AW Pension Plan increased by $3.0 million from $32.6 million in 2003 to $35.6 million in 2004 for the following reasons:

Increase for passage of time & normal plan operations	$ 0.5 million
Loss due to actual non-investment experience different from that assumed	1.5 million
(Gain) due to investment performance different from that assumed	(5.0) million
Change in discount rate*	5.4 million
Merger of St. Louis Plan	0.6 million
Total	3.0 million

* See explanation of this change in Assumptions section.

Assumptions

Please note that these estimates are based on the same basic economic assumptions as were used in the December 31, 2003 disclosure, as follows:

- Discount rate: 6.25% per year (6.75% for 2002)
- Expected annual return on assets: 8.75% for pension; 8.40% for other postretirement benefits
- Rate of annual compensation increase: 4.75%, on average
- Health care cost trend rate (as specified by AW):

Year	Trend
2004	10.0%
2005	9.0%
2006	8.0%
2007	7.0%
2008	6.0%
2009+	5.0%

The health care cost trend rate increased from an initial rate in 2004 of 8% to 10%. The ultimate rate remains at 5%

Witness Responsible:

Sheila Valentine

105. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), Workpapers 3-10 at 1-2. Provide for each listed expense account a detailed description of the items included in the account. State all assumptions used in developing the budgeted amounts for the forecasted test period and explain why such assumptions are reasonable. Explain and illustrate the relationship between the forecasted amount and a historical period where applicable.

Response:

Account-Description	Detail
520100.15-M & S Oper CA	Storage costs for files and other company records, CPR training fees, card keys for security system, imaging services
570100.15-Uncollectibles	Uncollectibles, charge-offs, and recoveries
575000.15-Misc Oper CA	Handbooks for OSHA related training, repairs to handheld meter reading devices, temporary staffing (clerk and service person), computer supplies
575100.15-Bank service charges	Bank fees
575200.15-Collection Agencies	Cost of bill collection services
575420.15-Forms CA	Fax paper, toner, receipt forms, bill forms, service orders, tap orders, log sheets, letterhead, envelopes, copy paper
575620.15-office & admin supp.	All miscellaneous office supplies including files, tabs, pens, pencils, staples, paper, toner, notebooks
575625.15-overnight shipping	UPS and Fed Ex costs
575660.15-postage CA	Postage expense
575740.15-Telephone CA	Telephone & teleconferencing costs – vendors include Alltel, AT&T, Bell South, Intelispan, Lightyear Communications, Verizon
575741.15-Cell Phone CA	Cellular telephone costs – vendors include Cingular Wireless and Nextel

Witness Responsible:

Sheila Valentine

The forecast was developed by considering any known and measurable changes to historical data. The reduction in overall customer accounting expenses is the result of the transition to the customer call center, as can be seen when comparing the 2003 and base period totals to the forecasted amounts.

Witness Responsible:

Sheila Valentine

106. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), Workpapers 3-11 at 1. Provide for each listed expense account a detailed description of the items included in the account. State all assumptions used in developing the budgeted amounts for the forecasted test period and explain why such assumptions are reasonable. Explain and illustrate the relationship between the forecasted amount and a historical period where applicable.

Response:

See the response provided to the Attorney General's First Data Request Item 138. For the electronic version, see file KAW_R_AGKYDR1#138_062504.doc and KAW_R_AGKYDR1#138_attachment_062504.pdf. Each lease is detailed by account and current lease amount.

Witness Responsible:

Sheila Valentine

107. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), Workpapers 3-12 at 1-3. Provide for each listed expense account a detailed description of the items included in the account. State all assumptions used in developing the budgeted amounts for the forecasted test period and explain why such assumptions are reasonable. Explain and illustrate the relationship between the forecasted amount and a historical period where applicable.

Response:

Account-Description	Detail
520100.16-M&S Operation AG	Cost of imaging documents, toner, newscast segments, data storage, employee screening, copy paper
575002.16-Misc General Expenses	Newspaper subscriptions, medical supplies, office supplies
575280.16 Dues/Memberships Ded.	CPA License renewal, Bluegrass Cross Connection Dues, Kentucky Bar Association, Rotary Club Dues, AWWA Dues, various Chamber of Commerce Dues, Fraternal Order of Police, Lexington Forum Inc., Kentucky Historical Society, Kentucky League of Cities, Better Business Bureau, Kentucky Rural Water Association
575320.16 Electricity	Electricity costs for office
575340.16 Employee Expenses	Various travel expenses of employees including lodging, airline fees, car rental
575342.16 Empl Exp Conference/Reg	Various registration & training fees – Personnel Training, Water Treatment Class, Treatment of Surface Water Training, Leadership Jessamine Co.
575350.16 Meals deductible	Deductible travel meal expense
575351.16 Meals & Travel Non-ded.	Non-deductible travel meals & expenses
575420.16 Forms AG	Envelopes, letterhead, labels, business cards, log

Witness Responsible:

Sheila Valentine

	Sheets
575480.16 Heat AG	Heating costs for office
Account-Description	Detail
575550.16 Janitorial AG	Cleaning costs of main office building
575620.16 Office & Admin Supplies	Amtz RIA Insource (Tax Software), imaging costs, miscellaneous office supplies such as paper, pens, files, notebooks, staples, etc.
575660.16 Postage	Postage machine costs, US Postal Service, UPS & Fed Ex Costs
575740.16 Telephone AG	Telephone & teleconferencing expenses – vendors include AT&T, Lightyear communications, Bell South, Verizon, Nextel
575741.16 Cell Phone AG	Cellular telephone costs – Cingular Wireless
575780.16 Trash Removal AG	Waste hauling
575830.16 Wtr & Wastewater Exp	Sewer charges

The forecast was developed by considering any known and measurable changes to historical data. Historically there is an overall reduction to general office expenses over the last three years, as well as the base period and projected forecast period. This recent downward trend can be attributed to the transition into the Shared Services Center.

Witness Responsible:

Sheila Valentine

108. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), Workpapers 3-13 at 1-2. Provide for each listed expense account a detailed description of the items included in the account. State all assumptions used in developing the budgeted amounts for the forecasted test period and explain why such assumptions are reasonable. Explain and illustrate the relationship between the forecasted amount and a historical period where applicable.

Response:

Account-Description	Detail
504610.16-Employee Awards	Employee service awards
504620.16-Employee Physical Exam	Cost of employee physicals and drug screening
504640.16-Safety Incentive	Cost of employee safety awards
504660.16-Tuition Aid	Employee tuition costs
504670.16-Training	Employee training costs
507100.16-401K	Company portion of 401K costs
508100.16-EIP Oper	Company match of Employee Investment Program
520100.13-M&S Oper WT	Kitchen & restroom supplies, toner miscellaneous Repairs, pager costs, medical supplies, keys
520100.14-M&S Oper TD	See detail for 520100.13
531000.14-Contract Svc Engineering	Contract engineering costs
532000.16-Contract Svc Accounting	Audit fees
533000.16-Contract Svc Legal	General legal fees including easements, Workers Compensation claims, property and zoning claims
535000.11 Contract Svc Other SS	Landscaping, tree removal, lawn care costs, exterminating, alarm system maintenance, miscellaneous repairs
535000.13 Contract Svc Other WT	See detail for 535000.13
535000.14 Contract Svc Other TD	See detail for 535000.13
535000.15 Contract Svc Other CA	See detail for 535000.13

Witness Responsible:

Sheila Valentine

535000.16 Contract Svc Other AG	See detail for 535000.13
535001.15 Contr Svc Temp Empl	Cost of temporary staffing
Account-Description	Detail
535001.16 Contr Svc Temp Empl	See detail for 535001.15
536000.13 Contr Svc Lab Testing	Lab testing costs
550000.16 Transportation Exp	Gasoline, vehicle repairs, inspections
575000.12 Misc Oper PU	Purchase of gravel, paint, light bulbs, safety shoes, miscellaneous lab supplies, water samples, equipment rental
575000.13 Misc Oper WT	See detail for 575000.12 above
575000.14 Misc Oper TD	See detail for 575000.12 above
575000.16 Misc Oper AG	See detail for 575000.12 above
575030.16 Advertising AG	General advertising, newspaper ads, Water Quality Reports, radio advertising
575220.16 Community Relations	Some company memberships and other community relations costs
575240.16 Co Dues/Memberships	Deductible individual memberships including AWWA, Bluegrass Cross Connection, Audubon Society
575242.16 Co Dues AWWA	Corporate AWWA Dues
575244.16 Co Dues NAWC	Corporate NAWC Dues
575271.16 Director's Fees	Quarterly Board of Director Fees
575320.13 Electricity PU	Electricity costs for facilities including the Richmond Road filter B building and lights
575320.14 Electricity TD	Electricity costs
575400.16 Business Services Proj Ex	Amortization of Shared Services Center costs
575480.11 Heat-Oil/Gas SS	Heating Costs
575480.13 Heat-Oil/Gas WT	Heating Costs
575480.14 Heat-Oil/Gas TD	Heating Costs
575490.16 Injuries & damages	Cost of repairs to damaged property not covered by insurance
575500.13 Janitorial WT	Cost of cleaning the facilities

Witness Responsible:

Sheila Valentine

575500.14 Janitorial TD	Cost of cleaning the facilities
575545.13 Lab supplies WT	Cost of miscellaneous lab equipment & supplies, lab testing, and lab gas
575620.13 Office & Admin Supp WT	Miscellaneous office supplies & medical supplies

Account-Description	Detail
575620.14 Office & Admin Supp TD	Miscellaneous office supplies & medical supplies
575625.14 Overnight shipping AG	UPS and Fed Ex Costs
575680.16 Research & Develop Ex	AWWA Research Fees & AWWA Foundation Fees
575711.16 Add'l Security Costs	Amortization of deferred security costs and cost of security guards
575740.13 Telephone WT	Telephone costs – vendor Cincinnati Bell
575741.13 Cell Phone WT	Cellular telephone costs – Cincular Wireless
575741.14 Cell Phone TD	Cellular telephone costs – Cincular Wireless
575780.11 Trash Removal SS	Trash hauling costs
575780.14 Trash Removal TD	Trash hauling costs
575820.13 Uniforms WT	Aramark Uniform Services – cost of uniforms
575820.14 Uniforms TD	Aramark Uniform Services – cost of uniforms
575830.11 Wtr & Wastewater Exp	Sewer Charges

The forecast was developed by considering any known and measurable changes to historical data. Transportation costs have been increasing and an adjustment was made for that additional expense. Condemnation costs were eliminated from the rate filing and reduced the miscellaneous expense line. The increase to additional security costs is the result of the amortization of the current deferred expense and the estimated additional security costs anticipated through November 2005. Overall the forecast is under the 2003 and the base period amounts.

Witness Responsible:

Linda Bridwell/Sheila Valentine

109. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), Workpapers 3-14 at 1. Provide for each listed expense account a detailed description of the items included in the account. State all assumptions used in developing the budgeted amounts for the forecasted test period and explain why such assumptions are reasonable. Explain and illustrate the relationship between the forecasted amount and a historical period where applicable.

Response:

Account-Description	Detail
620000.21 Materials & Supp Maint SS	Costs of pump and motor inspections and repairs, overhaul of intakes, preventative maintenance of incline car track
620000.23 Materials & Supp Maint WT	Cost of materials and repair parts for chemical feed equipment, settling basins, hydrotreators, filters, residuals, handling equipment, etc.
620000.24 Materials & Supp Maint TD	Test and repair meters, costs associated with the maintenance of mains, hydrants, services, miscellaneous meter repair parts.
635000.23 Contr Svc-Maintenance WT	Maintenance of chemical feed equipment, settling basins, hydrotreators, filters, residuals, handling equipment, etc.
635000.26 Contr Svc-Maintenance AG	Annual inspections of fire extinguishers, elevator inspections, inspection of fire suppression system, maintenance of alarm panel, general building maintenance.
675000.23 Misc Maintenance WT	Maintenance of lab instrumentation at Kentucky River Station and Richmond Road Station, miscellaneous service agreements for lab equipment

Witness Responsible:

Sheila Valentine

675000.24 Misc Maintenance TD	Roadway and sidewalk repairs, temporary staffing, backhoe and equipment rental, equipment repairs and maintenance
675050.21 Amortization Def Maint SS	Current amortization expense of maintenance to the KRS high service pumps 12 & 13, and the overhaul of the KRS high service pump 14 and the travel screens
Account-Description	Detail
675050.23 Amortization Def Maint WT	Amortization of various maintenance projects including the painting of hydrotreators, the KRS clearwell, and wastewater tanks
675050.24 Amortization Def Maint TD	Amortization of the painting of numerous tanks

The forecast was developed by considering any known and measurable changes to historical data, as well as anticipated maintenance as a result of annual inspections. Several inspections are overdue which results in the increase in the forecast expenditures. The detailed tank inspections for the 2004-2004 forecast period are included on W/P 3-14 page 3 of 9. The Company is also seeking additional amortizations of the Tates Creek tank painting, Sadieville standpipe repairs, Cox Street tank repairs, Cox Street ground storage tank painting, York Street tank painting, Sadieville tank painting, Kentucky River Station residuals cleaning, and the Tri Village Long Ridge tank painting.

Witness Responsible:

Michael A. Miller

110. Identify all costs related to the future retirement of assets included in rate base that were accrued by Kentucky-American pursuant to Statement of Financial Accounting Standard 143 "Accounting for Asset Retirement Obligations."

Response:

None in regards to the portion of FAS 143 dealing with legal obligations. Per FAS 143 the Company did disclose the level of salvage net of cost of removal embedded in its depreciation expense as approved in the Company's Commission approved depreciation rates.

Witness Responsible:

Sheila Valentine

111. Provide for each category set forth below a detailed listing of the amounts included in the forecasted operating expenses (above the line) by title and the account number used in the Uniform System of Accounts for Class A and B Water Companies:

a. Social and Service Club Dues.
b. Charitable Contributions.
c. Initiation/Country Club Expenses.
d. Employee Party, Outing and Gift Expenses.
e. Spousal Travel
f. Sales Promotion and Advertising
g. Civic, Political, and Related Activities
h. Employee Bonuses Outside of the Incentive Plans

Response:

a. See Exhibit 37F-1 in the original filing, lines 8 through 12. For the electronic version see file KAW_APP_EXE37F_043004.
b. None
c. None
d. None
e. None
f. See Exhibit 37F-4 in the original filing, page 8 of 11. For the electronic version see file KAW_APP_EXE37F_043004. The account number is 930890.
g. None
h. None

Witness Responsible:

Michael A. Miller

112. Provide a comparison of Kentucky-American's forecasted rate base, capital structure, and income statement from Case No. 2000-00120 with its actual results. Provide for each variance a detailed explanation for the variance.

Response:

See attached file KAW_R_PSCDR2#112_attachment_062804.pdf.

Witness Responsible:

Linda Bridwell

113. Provide a monthly comparison of Kentucky-American's forecasted construction expenditures from Case No. 2001-00120 with its actual results by construction project. Provide for each variance a detailed explanation for the variance.

Response:

Please see attached file KAW_R_PSCDR2#113_attachment_062804.pdf.

Witness Responsible:

Linda Bridwell

114. a) List each construction project that will be commenced and/or completed during the forecasted test period for which Kentucky-American, as of the date of this Request, has not obtained all necessary governmental permits, licenses, or other approvals.

b) For each project,

(1) List all required governmental permits, licenses, or other approvals.

(2) List those governmental permits, licenses, or other approvals Kentucky-American has not obtained as of the date of this Order.

(3) State the date Kentucky-American applied or expects to apply for such governmental permit, license, or other approval.

Response:

Please see attached file KAW_R_PSCDR2#114_attachment_062804.pdf.

Witness Responsible:

Michael A. Miller

115. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 10. The 10-year average ratio of actual to budgeted capital construction ("slippage factors") for the Investment P 074rojects B-H is 105.43 percent and 86.12 percent for the Investment Projects. Recalculate Kentucky-American's forecasted revenue requirement, rate base, and cost-of-service study as follows:

    a. Adjust all monthly Investment Projects B-H expenditures beginning February 2004 through the end of the forecasted test period, using the 105.43 slippage factor.

    b. Reduce all monthly Investment Projects expenditures beginning February 2004 through the end of the forecasted test period, using the 86.12 slippage factor.

    c. Provide all workpapers, assumptions, and calculations showing the effect of the slippage factors to each forecasted element of rate base, and cost-of-service study.

Response:

a-c. In order to respond to this data request, KAWC revised the spreadsheet files shown below. KAWC used the slippage factors requested above and also corrected the Contribution in Aid of Construction (CIAC) beginning balance (January 31, 2004) for each of the water systems as reflected in AG DR 111. Cash flow was reduced by the amount of the slippage. The Short-term debt was reduced by $770,000.

Shown below is a comparative summary of the rate of return, rate base, revenue requirement and cost of service elements between the Company's original filing and recalculation for slippage and CIAC correction.

Witness Responsible:

Michael A. Miller

	Original Filing	PSC Slippage and CIAC corrected
Revenue increase	$ 7,297,443	$ 7,418,795
Rate Base	158,958,817	159,776,728
Overall return	8.25%	8.25%
AFUDC	470,940	417,280
Property taxes	2,223,673	2,221,768
Depreciation	7,065,762	7,067,531
CIAC correction	34,547,915	33,064,060

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KAW_R_PSCDR2#115_SCHEDULEJ1_062804.pdf
KAW_R_PSCDR2#115_PROPTAX_062804.pdf
KAW_R_PSCDR2#115_DEFTAX_062804.pdf
KAW_R_PSCDR2#115_SCHEDULEE_062804.pdf
KAW_R_PSCDR2#115_PLANT_062804.pdf

Witness Responsible:

Linda Bridwell

116. For each investment project started and/or completed during the period 1994 through 2003, provide:

a. The number of investment projects that were completed ahead of schedule.

b. The number of investment projects that were completed on schedule.

c. The number of investment projects that were completed behind schedule.

Response:

Year	Total No. of IPs Completed	IPs Completed Ahead of Schedule	IPs Completed On Schedule	IPs Completed Behind Schedule
1994	6	1	2	3
1995	6	1	2	3
1996	14	4	4	6
1997	9	0	3	6
1998	7	3	1	3
1999	9	0	0	9
2000	7	3	1	3
2001	7	0	1	6
2002	7	0	2	5
2003	4	1	0	3

The same criteria were used for Investment Project completion that was used in previous cases.

Witness Responsible:

Linda Bridwell

117. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 10 at 1. Investment Projects 92-12, 96-19, 89-01, 98-08, 89-09 were originally scheduled for completion prior to 2003 but were not completed on schedule. Explain why, although $840,868 was expended on these projects during 2003, no funds were budgeted in 2003 for these projects.

Response:

The investment project expenditures identified represented carryovers from the 2002 investment plan. As the next year's budget is compiled in the early fall for approval at the December Board Meeting, Kentucky American Water does not attempt to budget for potential carryovers of expenditures unless the individual amount is extraordinary or the scope of work has significantly changed. The budget is "trued up" in February, after any carryovers are known.

Expenses for project 96-19 represented a scope change. Expenses for project 92-12 were supposed to be transferred to project 02-04, however, this transfer has not been completed.

Investment Project 98-01 was originally scheduled as the Integrated Resources Plan. Work in 2003 was not originally planned in the investment budget, however, as the Consortium was working towards an additional water supply it seemed appropriate to develop further planning on the existing production facilities and a draft review was completed. It is anticipated that the draft of that review will be finalized once the Consortium master plan is completed.

Witness Responsible:

Linda Bridwell

118. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), Workpapers 1-11. Provide for the deferred maintenance projects listed below the date on which the project was completed, a description of the project, and the basis for the amortization period:

   a. Work Order No. 1105, Paint Tates Creek.
   b. Work Order No. 1106, Sadieville Standpipe Repairs.
   c. Work Order No. 50030635, Cox Street Tank Repairs.
   d. Work Order No. 50030636, Tri-Village Paint Long Ridge Tank.

Response:

a. Project was to inspect, repair, clean and repaint heavily corroded interior portions of 0.5 MG Tates Creek Elevated Storage Tank. This project was not a complete repainting but was critical for maintaining water quality and enabled the delay of total recoating for several more years. Completed January 2003. Amortization period is 180 months based on previous tank painting amortizations.

b. Project was to clean, repair and repaint heavily corroded portions of the 0.38 MG Sadieville Standpipe. Painting work was completed in July 2001. Amortization period for this project is 180 months based on previous tank painting amortizations.

c. Project was to inspect, repair, clean and repaint portions of 1 MG Cox Ground Storage Tank after damage sustained from pilot valve failure on 8-inch globe valve that fills tank. This projected will not delay having to recoat the entire tank. Completed September 2003. Amortization period for this project is 180 months based on previous tank repair and painting amortizations.

Witness Responsible:

Linda Bridwell

d. Project is to repair, clean and repaint the existing 100,000 gallon Long Ridge standpipe in Owen County. Project was substantially completed in May 2004 and final completion expected by July 2004. Amortization period for this project is 180 months or 15 years based on previous tank repair and painting amortizations.

Witness Responsible:

Linda Bridwell

119. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 8. State when, if ever, Kentucky-American plans to undertake a new Least Cost/Comprehensive Planning Study such as it conducted in 1992.

Response:

In 1998, Kentucky American Water initiated an Integrated Resources Plan which would replace the 1992 Leas Cost/Comprehensive Planning Study. An extensive overhaul of the hydraulic model was undertaken to update the distribution system planning. During 1999, however, Kentucky American Water committed to pursue the preferred water supply solution identified by the Lexington-Fayette Urban County Government. This commitment led to Kentucky American Water's involvement with the Bluegrass Water Supply Consortium. Clearly any effort to complete a water supply portion of the Integrated Resources Plan would be premature to any effort of the Consortium. The Consortium efforts were to address the treatment capacity deficit, so any work on any long-term planning efforts on the production facilities would need to be in concert with the Consortium as well. Production facilities were reviewed for future regulatory compliance, and a draft chapter was developed with the intention to complete it when the water supply solution was identified. Further, the connection of a solution to the water supply situation would also impact the distribution system, so long-term planning on the distribution system beyond the hydraulic model update needed to await the efforts of the water supply solution. Essentially, the change in direction of pursuing a water supply solution delayed the ability to complete a new comprehensive planning study until a water supply solution is clearly defined. The Consortium has identified a long term water supply solution and is in the process of establishing itself as a legal organization. With that, it should be able to develop a more detailed master plan for solution implementation which will in turn provide Kentucky American with the direction needed to complete a new long-term comprehensive planning study.

Witness Responsible:

Linda Bridwell

120. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 9. For each of the budgeted projects listed below, provide a detailed description of the project and the basis for the budgeted amounts.

a. Source of Supply Project.

b. Source of Supply Project – Consortium.

Response:

a. The Source of Supply Development Project 02-04 includes a proposed $2,500,000 in both 2006 and 2007. The intent of these proposed expenditures were Kentucky American Water's proposed portion of a Phase I project for the Bluegrass Water Supply Consortium. At this time, a Phase I project is likely to be a grid system pipeline linking Frankfort, Kentucky American Water, Nicholasville and Winchester. At this time, there are no detailed descriptions of the projects, and the Phase I project has not actually been defined. The Bluegrass Water Supply Consortium is currently in the process of establishing itself as an organization and has not defined a funding method. The proposed capital expenditures beyond the forecasted test year are very general and are intended only to keep a marker of the effort moving forward in the capital planning process. Clearly these expenditures will be further defined as more details are available.

b. The Source of Supply Project – Consortium includes $5,000,000 in each of 2007 – 2010. This intent of this project is to represent Kentucky American Water's proposed portion of a Phase II project for the Bluegrass Water Supply Consortium. It is anticipated that at some point during Phase II, bonds may be issued to finance other Consortium expenditures and Kentucky American Water's additional obligations may be covered as fixed cost payments, capital expenditures not reflected in the plan,

Witness Responsible:

Linda Bridwell

or within purchased water expenses to the Consortium. Again, a Phase II project has not been identified and there are no detailed descriptions for the budgeted amounts.

Witness Responsible:

James E. Salser

121. Refer to the Direct Testimony of James E. Salser at 3.
   a. Explain why 12 months of data was analyzed for the expenses while only 91 days was used for the revenues.
   b. Explain why 2002 data was used to analyze revenues.

Response:

a. The company began billing under a new customer billing system on October 17, 2003 that reduce the of lag day between the reading date and the bill date.
b. On page 3 of my Direct testimony line 3 the date should read January 15, 2004 instead of January 15, 2002.

Witness Responsible:

Michael A. Miller

122. Refer to the Direct Testimony of Michael M. Miller at 6-8.

    a. As of March 1, 2004, Kentucky-American has issued $38 million of its authorized long-term debt of $41.5 million, but it intends to issue an additional $5.5 million of long-term debt in the forecasted test-period. State whether Kentucky-American intends to request Commission approval before issuing the $5.5 million of new debt.

    b. State whether Kentucky-American issued any common stock when issuing the $38 million of long-term debt. If Kentucky-American issued common stock, describe the issuance.

Response:

a. Yes.

b. No.

Witness Responsible:

Michael A. Miller

123. At Exhibit 17, page 3, of its Application, Kentucky-American predicts that its equity-to-capital ratio will exceed 45 percent in calendar years 2005 and 2006. State and describe the actions that Kentucky-American intends to take to maintain equity-to-capital ratio between 35 to 45 percent as the Public Service Commission of Kentucky directed in Case No. 2002-00317.

Response:

The Common Equity Ratio shown on Exhibit 17, page 3 is as follows.

2004 – 40.98%

2005 – 42.60%

2006 – 43.87%

The Company believes the condition referred to above in Case No. 2002-00317 applies to the Common Equity Ratio. The common equity ratios listed on Exhibit 17 comply with the Order of the Commission.