Witness Responsible:

James H. Vander Weide, Ph.D.

1. a. Identify all studies of which Dr. Vander Weide is aware that estimate the price elasticity of demand for water or natural gas in either Kentucky or the United States.

   b. For each study listed in Item 1(a), provide a paper and electronic copy and state the study's estimate of the price elasticity of demand for water or natural gas.

Response:

a. Since Dr. Vander Weide's testimony is not based on an estimate of the price elasticity of demand for water or natural gas in either Kentucky or the United States, he did not estimate the price elasticity of demand for water or natural gas in either Kentucky or the United States. The Company has informed me that it commissioned a study of the price elasticity of demand for water in May 1995. However, I have not seen this study, nor am I aware of other studies of the price elasticity of demand for water or natural gas.

b. See response to a.

Witness Responsible:

Coleman Bush

2. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information Requests, Item 52. Provide the requested labor costs in the format set forth in Schedule 1 in paper medium and as an Microsoft[â] Excel 97 spreadsheet.

Response:

See attached schedule.
For the electronic version see KAW_R_PSCDR3#2_attachment_080604.xls and/or KAW_R_PSCDR3#2_attachment_080604.pdf.

Witness Responsible:

Sheila Valentine

3. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1 (a), Workpapers 3-1 at 2 and Exhibit 37, Schedule C-2 at 1. According to this workpaper, the forecasted levels of EIP and 401k expenses are $36,503 and $76,355, respectively. Identify the forecasted expense account contained on Schedule C-2 where the "EIP and 401k expenses are recorded.

Response:

The EIP expense is included in AWW account 926220 and the 401K expense is included in AWW account 926250 (see detail on Schedule D-1C page 16 of 19). Both amounts fall within the miscellaneous expense line detailed on Schedule D-1C page 18 of 19 and Schedule C-2 page 2 of 4.

Witness Responsible:

Coleman D. Bush

4. In its response to Commission Staff's Second Set of Information Requests, Item 52, Kentucky-American states that, "[t]he 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 the preparation of the budget."
   a. Identify and describe each instance in which Kentucky-American adjusted the originally budgeted amount of time for known and measurable changes.
   b. Describe the process that Kentucky-American uses to identify the adjustments listed in Item 4(a).
   c. Describe the approval process that Kentucky-American and American Water Works Company ("AWWC") use for the changes in the approved budgets.

Response:

a. The approved budget included 134 positions. One of these positions belonged to the manger of our Pineville operation and that position was not included in the case. Two other positions, Vice President of Operations and Senior Secretary were in the approved budget but removed from the case. Both positions were eliminated from Kentucky-American Water Company. We included 2 teller positions in the rate case that were not in the approved budget. The final number of employees included in the rate case is 133.

b. Our 2004 and 2005 budgets were approved late in 2004. Based on known operational changes, local management recommended these changes to the Managing Director of the Southeast Region.

c. The Board of Directors of Kentucky-American Water Company approved the filing of the case, including any changes from the approved budget, based on a recommendation from the management of Kentucky-American Water Company.

Witness Responsible:

Michael A. Miller

5. a. List all costs related to Roy Mundy's employment that are included in the forecasted test-period operations.

   b. Describe how those projected costs will change as a result of Mr. Mundy's retirement and the appointment of an acting President. Provide all workpapers, show all calculations, and state assumptions used to develop the estimate of any changes in projected costs.

Response:

a. Please see the response to AG2-question 24 for detail of Mr. Mundy's expenses included in the forecasted test-year period.

b. Please refer to the response to AG2-question 24 for the change in forecasted test-year costs that will change as the result of Mr. Mundy's resignation.

Witness Responsible:

Linda Bridwell

6. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information Requests, Item 56(a). State whether the forecasted consulting fees have been adjusted to reflect the filling of the operations engineer position. If adjustments have been made, identify all adjustments to the consulting fees that have been included in the forecasted test period.

Response:

The position of operations engineer deals primarily with capital expenditures. The capital expenditures forecasted are estimated based on using in-house personnel for project management as opposed to consultants. No specific adjustments were made to those project costs as it was anticipated that the position would be filled.

Witness Responsible:

Sheila Valentine

7. Refer to Kentucky-American's application, Exhibit 37, Schedule C-2 at 1.

   a. Provide a detailed description of the forecasted gross receipts and sales tax expense totaling $78,504.

   b. Explain why forecasted gross receipts and sales tax expense totaling $78,504 is included in forecasted operations.

Response:

a. The $78,504 is the amount included in AWW account 408110 for the Annual PSC Fee. The calculation of this tax is included in the original workpapers 5-2 page 1 of 4. There are no amounts included in the revenue requirement for sales tax expense.

b. The PSC fee is a general tax paid on behalf of Kentucky American Water and is an expense that is part of the normal operations of the business.

Witness Responsible:

Sheila Valentine

8. State the amount of sales taxes that Kentucky-American estimates to pay on its projected purchases in the forecasted test period.

Response:

KAWC does not normally segregate the amount of sales tax it pays on the purchase of material, supplies and equipment, but charges that to the appropriate account where the purchase applies. The total of the purchase plus sales tax is carried forward into the forecasted period. The Company is not able to segregate the sales tax portion.

Witness Responsible:

Michael A. Miller

9-1. Refer to the attachment to Kentucky-American's Response to Commission Staff's Second Set of Information Requests, Item 57.

a. Provide a comparison for each of the calendar years 2001, 2002, and 2003 by employee of the amounts budgeted for the Annual Incentive Plan ("AIP") and those actually paid.

b. Explain the level of increase in amounts of AIP included in the forecasted period as compared to the amounts paid in the 3 most recent calendar years.

Response:

a. Kentucky American Water does not budget Annual Incentive Plan costs by employee. The amounts in total were:

	Budget	Actual
2001	$156,347	$219,498
2002	$226,308	$139,700
2003	$113,136	$ 78,500

Please see response to PSC2-question 52 and attachment KAW_R_PSCDR1#1a for detail of the level of incentive plan costs by employee included in the forecasted period. Please see response to PSC2-question 57(b) for explanation of how the forecasted period incentive plan costs were calculated.

b. The level of AIP for the forecasted period was determined as described in the response to PSC2-question 57(b), the actual plan guidelines are described in the response to AG1-question 123 and described in the testimony of Mr. Miller. The forecasted period AIP payments are approximately $10,000 more than paid in 2001. In both 2002 and 2003 the Company did not meet the financial targets established for full pay-out under the plan and payments were made in 2003 only for the portion of

Witness Responsible:

Michael A. Miller

the AIP that applied to the operational and customer service targets. The Company believes that the setting of fair and reasonable rates in this case will provide the Company an opportunity to meet the financial targets for the forecasted period, given the continued efforts of the Company to improve efficiency and control costs.

Witness Responsible:

Michael A. Miller

9-2. a. For each Kentucky-American employee who performed work activities related to Kentucky-American's defense against Lexington-Fayette Urban County Government's ("LFUCG") condemnation action, provide the employee's name, position, and the hours worked in the base period on condemnation proceeding-related activities.

b. For each employee who Kentucky-American projects to work on condemnation proceeding-related activities in the forecasted period, provide the information requested in Item 9(a).

c. Identify each American Water Works Service Company ("Service Company") employee who will work on condemnation proceeding-related activities during the base period or the forecasted period. Provide the allocation of their salaries for the time involved in condemnation proceeding-related activities that is included in the base period or forecasted period.

Response:

a. Kentucky American Water has considered the efforts on the condemnation to be within normal expected activities of KAW employees to participate in the effort fight the unwanted and forced acquisition of the Company and has not tracked individual employee hours worked in the base period on the condemnation action. Any number of management and support employees have assisted in the extra duties placed on the Company by the condemnation proceeding initiated by the LFUCG. Also please refer to the responses to LGUCG2 – questions 19, 20, 28, 29, 31, 32, 33, 35, and 37.

b. Kentucky American Water considers the efforts on the condemnation action to be within normal expected activities of KAW employees to participate in the effort to fight the unwanted and forced acquisition of the Company and has not budgeted individual employee hours specifically for this effort.

Witness Responsible:

Michael A. Miller

c. American Water has considered the efforts on the condemnation to be within normal expected activities of service company employees to participate in the effort fight the unwanted and forced acquisition of the Company and has not tracked individual employee time on the proceeding for base or forecasted periods. Also, please refer to response to LFUCG2-question 31 and 37.

Witness Responsible:

Coleman Bush/Michael A. Miller

10. Refer to Kentucky-American's Response to LFUCG's First Set of Information Requests, Item 21(d).

    a. Estimate the effect of the identified employee retirements, resignations, and hirings upon Kentucky-American's forecasted operations and revenue requirement. Show all calculations, provide all workpapers, and state all assumptions used in this response.

    b. Provide the positions that Barnett and Smithers filled.

Response:

a. To the extent that the positions are included in the rate case, the Company intends to fill all vacancies created by retirements and resignations. Union positions will be filled at the identical salary and non-union positions will be filled at market rates.

b. We erred in the spelling of the last name of Mr. Robert Barrett. He was hired as a meter reader and Mr. Smithers was hired into a Utility position in the Distribution Department.

Witness Responsible:

Michael A. Miller

11. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information Requests, Item 59. Explain why, if Barbara Brown, David Whitehouse, and Roy Mundy are devoting a portion of their working time to condemnation proceeding-related activities, the portion of their salaries related to such time should be considered in calculating Kentucky-American's rates.

Response:

Please see response to LFUCG2-question 37. Also see responses to LFUCG2-questions 19, 20, 28, 29, 31, 32, 33, and 35. Also, see response to PSC2-question 9-2 above.

Witness Responsible:

Michael A. Miller

12. Refer to the Direct Testimony of Michael A. Miller and Kentucky-American's Response to Commission Staff's Second Set of Information Requests, Item 61.

    a. Explain why, as no Cost-of-Service Study has been performed since Kentucky-American's acquisition of the Elk Lake Homeowners Association and Tri-Village Water District systems, it would not be reasonable to determine the total percentage increase of the revenue requirement of the entire system and increase all customers' current rates by that percentage amount.

    b. State the rates for each Division if the method set forth in Item 12(a) were used. Provide all workpapers, state all assumptions, and show all calculations used to calculate the rates in paper medium and as an Microsoft® Excel 97 spreadsheet.

Response:

a. The Company has proposed separate tariffs for each of its three districts based on the cost attributable to each district, except for the request to phase in the allocation of certain corporate costs as explained in the testimony of Mr. Miller and in the response to PSC2-question 61. The Company has not provided a cost of service study with this filing, but the Company has no strong objection if it is the desire of the Commission to move in the direction of a single tariff in this case and to spread any rate increase approved in this case by increasing all rates equally on a percentage basis. The Company has stated its intent to file a class cost of service study and to request a single tariff for its current customers in the next rate case. Such an allocation as described in this question would also serve to meet the regulatory principle of "gradualism" in setting the rates for the customers in the Northern Division in this case.

Witness Responsible:

Michael A. Miller

b. Please see the schedules attached as KAW_R_PSC3#12b_attachment_080604.pdf

The Microsoft Excel version can be found as KAW_R_PSC3#12b_attachment_080604.xls

The only assumption made by the Company was that each existing billed usage and meter or connection tariff provision for each of the three districts was increased by an overall billed tariff increase of 15.849%. The Company determined the overall % by taking the total increase in revenue less the amount requested from the activation fee divided by the going level amount of revenue derived from billed tariffs at present rates.

Calculation:

Total Rate Increase	$ 7,297,602
Revenue from activation fee	$ 671,942
Rate increase from billed tariff	$ 6,625,660
Revenue from tariffs at present rates	$41,803,966
Overall % increase in billed tariffs	15.849%

Witness Responsible:

Michael A. Miller

13. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information Requests, Item 61(b). The response is not responsive. Explain why the referenced testimony does not state why it is fair to the customers of the Central Division that they should be asked to subsidize the rates of the Northern Division. Provide the information as originally requested.

Response:

Mr. Miller's testimony does address this cost of service allocation issue and explains that due to the significant increase for the Northern Division customers, the Company was proposing an often used regulatory principle of gradually moving towards cost of service targets when rate shock could be an issue. The Company did not believe it was necessary to include an explanation of fairness when proposing such an often used regulatory principle. Short of a cost of service study that determined the cost to provide service to each customer, cost of service allocations would never produce the true cost for each customer. Such an approach is unrealistic and not feasible. The customers in the Central Division are receiving a direct benefit in this case from the Company's efforts in the form of a lower cost of service because of the allocation of fixed management costs and direct charges of Central Division hourly employees for actual time worked to the Northern Division operations, and to the O&M contract operations in Pineville and Bluegrass Station. The Company is not proposing a full allocation of management costs to the Northern Division in this case, but the proposed rate increase for the Northern Division is significant. The Company has relied on the principle of gradualism in regard to the full allocation of management costs in this case. That does not mean the tariffs proposed for the Central Division customers are unfair, and they are still receiving a direct benefit in this case.

Witness Responsible:

Michael A. Miller

As indicated, the Company's proposed allocation in this case is consistent with the concept of gradualism in setting rates and is in line with the Company's intention to propose a single tariff pricing in its next rate case. The concept of single tariff pricing is utilized by many regulatory jurisdictions for multi-district water companies. The concept of single tariff is predicated on the fact that each customer receives a uniform level of service from a largely centralized operation with a unified capital requirement and pays the same price as other customers in that customer classification. It is cost based ratemaking, but is a different method of allocating the cost of service to the various classes of customers. The concept also takes into account that over time the cost of service to the various districts will be allocated fairly as the timing of major construction projects and other elements of the cost of service may dictate fluctuates (both up and down) among the allocations between customer classes and customers in the various service areas. The Central Division customers would benefit if a single tariff pricing concept were approved prior to the major construction of the source of supply solution for Central Kentucky, and the Northern Division customers shared in that cost.

The Company also believes that cost allocations under the single tariff pricing would enhance the Company's potential for additional growth through acquisitions and promote economic development. All customers share in the additional revenue coming directly to the Company and in the general economic benefit of development and job creation no matter where in the service territory that growth occurred.

Witness Responsible:

Michael A. Miller

14. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information Requests, Item 61(c). Provide all memoranda, correspondence, electronic mail messages, and other documents in which employees of Kentucky-American, Service Company or AWWC or persons retained by those companies discuss the development of a uniform tariff for Kentucky-American or the submission of such tariff to the Commission.

Response:

To the best of our knowledge the Company does not know of any correspondence or documents specific to the development of a uniform tariff for KAWC. In meetings and discussions with a number of employees at AWW where rate matters are discussed, such as meetings of the VP's of Finance and Directors of Rates, it has been expressed that, where feasible and appropriate, AWW supports the concept of single tariff pricing for all the reasons covered in the response to PSC3-quesiton 13 above. Mr. Miller has had discussions with Roy Ferrell, Chris Jarrett, Roy Mundy and others about proposing a single tariff for KAWC now that KAWC has multiple districts. Mr. Ferrell and Mr. Miller have discussed the Company's intention to prepare a cost of service study for the next KAWC rate case along with a customer demand study that would be needed to complete the cost of service study. In fact, prior to filing this case, the Company did have conversations with Paul Herbert about the need to prepare a cost of service study and decided that since the last cost of service study was filed in case 2000-120 and there were no major changes in the cost of service components since that study, we would propose an across the board increase for the Central Division in this case. We also had preliminary discussions with Mr. Herbert concerning the Company's intent to prepare a demand and cost of service study for its next rate filing, and the Company's intent to propose a single tariff for its operations.

Witness Responsible:

James Salser

15. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information Requests, Item 61(d). State the rates that Kentucky-American would have proposed if a uniform schedule of rates were proposed instead of differing rates for each division. Provide all workpapers, state all assumptions, and show all calculations used to calculate the effects of a uniform tariff in paper medium and as an Microsoftâ Excel 97 spreadsheet.

Response:

Please see the response to item 12b. For the electronic version please refer to KAW_R_PSCDR3#12_attachment_080604.pdf

The Microsoft Excel spreadsheet can be found as KAW_R_PSCDR3#12_attachment_080604.xls

Witness Responsible:

Coleman D. Bush

16. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information Requests, Item 62(b). This response did not contain the methodology used to allocate Kentucky-American employee time to unregulated activities. Provide the methodology Kentucky-American used to develop "an appropriate number of hours" that it allocates to its unregulated activities. If each employee is responsible for recording on his time sheet the amount of time spent on unregulated activities, describe the internal controls used to ensure accurate reporting.

Response:

The forecast for labor hours charged directly to Bluegrass Station Division was developed after consulting with Dillard Griffin, Joe White's supervisor. Mr. Griffin estimated, based on his experience, that Mr. White would need to dedicate 360 hours of his time annually to operations at the Bluegrass Station Division. This is the majority of the 489 hours that are included in capital and other labor for Mr. White in the forecast.

Mr. Mattingly estimated that he spends 48 hours annually on the Kentucky River Authority Leak Detection Program. This is only a part of the 417 hours that Mr. Mattingly has included in capital and other labor for the forecast. The hours allocated to the KRA Leak Detection Program by field personnel were based on the history of the program.

All employees, whether budgeted to unregulated activities or not, are expected to charge time as spent. Timesheets require supervisory approval and it is expected that the supervisors will provide the internal controls necessary to ensure accurate reporting.

The expenses for the Pineville supervisor are not included in this case.

Witness Responsible:

Coleman D. Bush

Labor for other employees has been allocated in the case to unregulated activities at Bluegrass Station Division and Pineville based on number of customers as shown in KAW_DT_CDB_EX1_043004 as filed with my direct testimony. We will follow the allocation method approved in this case for those positions listed.

Witness Responsible:

Coleman Bush

17. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information Requests, Item 63.

    a. State whether Kentucky-American has ever realized a profit in a 12-month period for its unregulated activities.

    b. State whether Kentucky-American has considered discontinuing its unregulated activities.

    c. Describe the accounting procedures that Kentucky-American uses to ensure that the each expense category listed below is properly recorded as unregulated:

        (1) Labor
        (2) Group Insurance
        (3) Pensions
        (4) Insurance other than Group
        (5) General Office Expense
        (6) Miscellaneous
        (7) General Taxes
        (8) M&J Expenses

    d. In Exhibit 1 of his testimony, Mr. Bush allocates direct and common costs to the unregulated activities for the rate case.

        (1) State whether Kentucky-American allocates these costs on an annual basis to the unregulated operations.
        (2) If Kentucky-American allocates these costs on an annual basis, explain the allocation process used.
        (3) If Kentucky-American does not allocate these costs on an annual basis, explain why the costs are not allocated.

Witness Responsible:

Coleman Bush

Response:

a. When looking at the schedules attached to the response to PSC2#63 neither the Pineville nor Bluegrass Station Division recorded a profit in 2003. Pineville also operated at a loss in 2002. The Company does expect to modify the costs of these two operations in order to move both of them to profit-making businesses.

b. The Pineville and Bluegrass Station contracts were the Company's first endeavors into contract operations. The Company has learned from its experiences and expects to adjust the operations of those entities to realize a profit. The Company will utilize the experience with Pineville and Bluegrass Station Division to improve on its management of any future contracts that it may decide to pursue. The Company also believes that these two contracts and potential future contracts have and will benefit the Central and Northern division customers by spreading its fixed costs over a larger customer base.

c. (1) Direct labor costs for Pineville and Bluegrass Station Division are allocated to the unregulated businesses through use of a subledger attached to the account number. The expenses are initially recorded above the line; then as part of the month-end closing are moved below the line through an automatic allocation routine. Labor charges for the Kentucky River Authority Leak Detection work are charged to a subledger which is directed below the line.

(2) Payroll overheads are allocated below the line as a multiple of labor dollars.

(3) Same as 17.c (2)

(4) Worker's Comp is allocated as part of payroll overhead when Kentucky American Water employees charge time to these contracts. Under our O&M

Witness Responsible:

Coleman Bush

contract with Pineville, the employees remained employees of the Pineville Utilities Commission. Labor and related costs for Pineville employees are paid by Kentucky American Water from O&M fee proceeds. We are not responsible for the expenses of any BGSD employees under our contract. Since these are O&M contracts, each entity carries its own property, liability, automobile and other non-group insurance and pays its own expenses for this coverage. We do not allocate any other insurance to these contracts.

(5) For Pineville, general office and miscellaneous expenses are paid by Kentucky American Water from O&M fee proceeds. Any such expenses for the BGSD contract are charged to the proper subledger. The expenses for the KRA Leak Detection contract are predominantly labor costs. Mileage expenses are allocated as part of payroll overhead. Any expenses such as travel costs for overnight stay, meals, etc. should be charged to the correct subledger directing those costs below the line.

(6) Same as 17.c (5)

(7) Payroll taxes are allocated as a percentage of labor. General property taxes, if any, would be borne by the owners of the property. The Company does not allocate any of its property taxes to these contracts.

(8) The BGSD contract does include a provision for work outside the contract. We have assigned a subledger for this work so that it is accounted for as M&J work below the line.

d. (1) The costs included in Exhibit 1 of my testimony have not heretofore been allocated to these contracts.

(2) The Company will begin making monthly allocations of costs once a method of cost allocation is approved by the Commission. This allocation will be subject to an annual true-up.

Witness Responsible:

Coleman Bush

(3) While these costs are properly allocable to the unregulated businesses, since we were between rate cases, the Company chose not to make an actual allocation of costs as it would not have an immediate impact on the rates paid by its Central and Northern Division customers.

Witness Responsible:

Michael A. Miller

18. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information Requests, Item 65.

    a. In this response Kentucky-American states that, "[t]here appears to be 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." List each issue to which Kentucky-American is referring.

    b. Explain how, as Kentucky-American has not provided information to requests that it deems irrelevant, responding to such information requests increases projected rate case cost.

Response:

a. The primary issue to which we were referring to in this response relates to the condemnation effort by the LFUCG. The Company has explained in detail its position about Company labor related to the condemnation in numerous and repetitive questions by the LFUCG in the supplemental data requests, as recapped in the response to PSC3-questions 9-2 and 11. The Company has not requested any rate recovery for additional external costs related to the condemnation effort by the LFUCG. There were a number of questions in the First LFUCG data request concerning those costs that are not being requested in the forecasted test-year cost of service requested in this case.

b. The Company reviews each discovery request for the type of information, what information it has available, and what relevance it has to the case, before tendering any response to a discovery request. This process can involve any number of KAWC and service company employees, and discussion with legal counsel. Whether or not the Company ultimately decides to provide the answer or object to the relevance of the question requires time and expense which ultimately equates to additional cost to process the rate case.

Witness Responsible:

Michael A. Miller

19. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), Workpapers 3-8 at 1. For each component listed below, provide the name of the person providing the service; the hourly rate charged by the person; the initial budgeted time of each individual to complete the application process; the actual time and amounts billed by each individual to date (include copies of invoices); and an estimate of the amount of time that will be required to finish the application process.

    a Legal Fees $280,000
    b. Rate of Return Consultant $26,350
    c. Lead Lag Study $20,000
    d. Consultant – Rate Filing $50,000
    e. Service Company Consultant – Baryenbruch $20,000
    f. Security Consultants $15,000
    g. Weather Normalization $17,119
    h. Other $37,000

Response:

See attached schedule and copies of invoices.

For the electronic version please refer to KAW_R_PSCDR3#19_attachment_080604.pdf

Witness Responsible:

Michael A. Miller

20. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information Requests, Item 69, and Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), Workpapers 3-8 at 1.

    a. Explain why, if the contract price for Dr. James Vander Weide is $25,000, $26,350 is included in the calculation of rate case expense.

    b. Explain why, if the contract price for Kenneth Rubin is $16,000, $15,000 is included in the calculation of rate case expense.

Response:

a. The difference noted in this question is for out of pocket expenses for attending rate hearing, i.e. hotel, air fare etc.

b. The final contract was slightly higher than the Company included in rate case expense projection.

Witness Responsible:

Michael Miller

21. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information Requests, Item 71(c). For each component of the Overhead ratio listed below, describe how the component was calculated, show all calculations, and state all assumptions used to make the Overhead ratio calculation.

    a. Pensions 19.75%

    b. Workers' Compensation 1.19%

    c. Group Insurance 16.99%

    d. OPEB's 12.69%

    e. Transportation 5.79%

Response:

Please see file KAW_R_PSCDR3#21_attachment_080604.pdf. The ratios are determined by dividing the budgeted pension, group insurance, worker's compensation, OPEB's and transportation expense by the budgeted labor cost to arrive at the overhead rate.

Witness Responsible:

Michael A. Miller

22. Refer to Kentucky-American's Response to the Attorney General's First Request for Information, Item 81, and Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), Workpapers 3-5 at 1. Provide a revised organizational chart that includes the following subsidiaries:

    a. Belleville Lab
    b. National Call Center
    c. Corporate
    d. ITS
    e. Shared Service Center
    f. Southeast Region

Response:

The Company is providing each of the organization structures for the entities identified below in subparts a. through f. Each of the entities requested below are offices of American Water Works Service Company, Inc.

a. Belleville Lab – See KAW_PSCDR3#22_attachment2, page 4 of 17.
b. National Call Center – See KAW_PSCDR3#22_attachment2, page 3 of 17.
c. Corporate – See KAW_PSCDR3#22_attachment 1, pages 1 thru 14
d. ITS – See KAW_PSCDR3#22_attachment 2, pages 6 thru 11.
e. Shared Service Center – See KAW_PSCDR3#22_attachment2, pages 12 thru 17.
f. Southeast Region – See KAW_PSCDR3#22_attachment3, pages 1 thru 13.

Witness Responsible:

Chris Jarrett/Michael A. Miller

23. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information Requests, Item 58, and Kentucky-American's Response to LFUCG's First Request for Information, Item 19 at 53.

    a. Explain how Roy Mundy was responsible for Kentucky-American's day-to-day operations if the "business in Kentucky will be managed in line with the general Business Model Principles and will report on a functional basis into the Regional Directors based in Hershey."

    b. Explain how management of Kentucky-American at the regional level in "Hershey" is local control.

    c. At page 2 of his direct testimony, Chris Jarrett states that, "I am ultimately responsible for the development, management and operations of Kentucky American Water's system, in Kentucky." Describe the management changes and/or restructuring that has occurred since the issuance of the AWWC Communication that gives control and responsibility for the daily management of Kentucky-American to Mr. Jarrett. Provide all documents that evidence or direct this management change or restructuring.

Response:

a. Roy Mundy and now Nick Rowe as President of the Company will oversee all local issues, including coordinating day to day activities, regulatory and community relations, and condemnation activities as required. This is no different than the current organization structure. The local department heads of KAWC have had functionally reportability to the Regional President, VP of Finance, VP of Operations, and the directors of water quality, engineering, rates, finance, HR, and risk when they have reported to a regional office of American Water.

Chris Jarrett/Michael A. Miller

Witness Responsible:

Historically, American Water subsidiaries have operated in this manner in order to coordinate functional activities in as uniform, consistent and cost effective manner as possible. This functional reportability has served American Water well in that it has and will continue to permit the sharing of best practices with other subsidiaries and permit KAWC to draw on experience and expertise of the American System not always available or obtained cost effectively at the local level. The realigned organization will be no different other than the new regional office will be located in Hershey, PA. Mr. Rowe will continue to oversee and coordinate local functions with the regional team and to make sure those functional activities are in line with local service requirements.

b. The employees of KAWC located in Kentucky will report directly to Mr. Rowe as President of KAWC, but report functionally to the regional directors in their particular area of the business, just as they have historically operated when KAWC has reported to the SE Region Office in Charleston, WV, and prior to that the Regional Office located in Richmond, Indiana.

c. Mr. Jarrett was elected to the Board of Directors of KAWC in April, 2000 shortly after KAWC was realigned with the SE Regional Office in Charleston, WV. He was recently re-elected to the Board of Directors of KAWC, and re-elected as Chairman of the Board of Directors and a member of the executive committee. In his role as Chairman of the Board of Directors of KAWC he was and remains responsible for the duties described in his direct testimony. Mr. Jarrett has and will continue to carry out those duties through communication and coordination with the President of KAWC. The minutes of the Board of Directors meeting held on July 21, 2004 are not complete as of submission of this response. As soon as those minutes are available the Company will supply them in a supplemental response to this request.

Witness Responsible:

Chris Jarrett/Michael A. Miller

24. a. Describe the reorganization that AWWC is currently undertaking. This description should include the original intent and goal of the reorganization and revisions that have occurred during the reorganization process. Do not refer to the memorandums included in Kentucky-American's Response to LFUCG's First Request for Information, Item 19.
b. State the date the reorganization process began and its expected date of completion.
c. Explain in detail how the AWWC reorganization will affect the management of Kentucky-American and its workforce.
d. If Kentucky-American has projected the effect of the reorganization and included it in its forecasted operations, identify in this proceeding where the effect(s) of the AWWC reorganization have been incorporated into Kentucky-American's forecasted operations.
e. If Kentucky-American has not projected the effect of the reorganization and incorporated it into its forecasted operations, provide an estimate of how the reorganization will impact Kentucky-American's forecasted operations. State all assumptions, provide all workpapers, and show all calculations used to make this estimate.
f. Provide readable organizational charts comparing the AWWC organization pre- and post-reorganization. Do not reference Kentucky-American's Response to LFUCG's First Request for Information, Item 19 at 53.

Response:

24. a. The Company provided a great deal of information regarding the reorganization currently underway at American Water in response to LFUCG1-question 19. Some of the organization structure documents were unreadable in the electronic filing PDF format and the Company apologizes for that. We have provided readable organization structures in response to question 22 above and are hopeful this has clarified any difficulty in understanding the new organizational structure. The response to the LFUCG's First Request for Information, Item 19, set forth the intent and goal of the reorganization and is appropriately from AWWC. It would be unfair to require KAWC to describe the reorganization without regard to the source documents that provide that information. It is impossible to describe the current reorganization without referring to the memos and other correspondence included in the response to LFUCG1-#19. The reorganization effort was initiated shortly after Jeremy Pelczer's election as President of American Water. The information supplied in the response to LFUCG1-#19 are the direct communications by Mr. Pelczer to the employees of American Water and although substantial in volume describe his vision for the Company, the strategic goals the organization will strive to meet and the reasons for the need for change in the

Witness Responsible:

organization. There are at least two areas of the response to LFUCG1-#19 which provide a summary of the intent and goals of the reorganization. The first recap area is contained on KAW_R_LFCDR1#19_attachement1_062504 at page 35 of 74. The responses to the first two questions provide a summary of the intent and goals of the reorganization. Those questions and answers read as follows:

1.Q. Whey are we making these changes?

A. All of our people are committed and take pride in our business, however, there are a number of compelling reasons for change: the desire to better service the needs of our customers; the need for better quality leadership; the need to more efficient in order to minimize increases in rates; the desire to ensure that we work smarter and together in teams; to ensure that we provide better feedback and professional development for our employees; and to facilitate better communication between managers and employees. There are also a number of external factors that are creating pressure on the business: the current economic downturn; weather impacts over the last two years; increased operating cost (through increases in insurance, healthcare, security, etc.); and condemnations. The combination of these challenges is significant for the business, but it is within our capabilities to achieve our goals and overcome these challenges.

2.Q. What impact will these changes have to our customers and the communities we serve?

A. We remain absolutely committed to the communities and customers that we currently serve and by being highly efficient and effective, we feel confident that we will meet the needs of our customers going forward and attract new customers. The organizational changes are intended to ensure that we have the best operating practices consistently applied across the Company to enable us to deliver the highest quality service. Changes in personnel at the top of the business will be carefully managed with our external stakeholders to reassure them that there is continuity of service and that the integrity of our operations is enhanced by these changes. We are confident that the new organization and the culture that we are creating will enhance our reputation with our customers and in the community.

In addition, please refer to KAW_R_LFCDR1#19_attachment1_062504 at page 18 that provides in bullet format the aims of the new American Water organization.

The reorganization has developed in phases beginning with executive team reporting to

Witness Responsible:

Mr. Pelczer and the realignment of the organization into four regional offices from the 7 regional offices previously. The reorganization continued in phases that proceeded next to the positions reporting to phase one positions, next to those reporting at the next level and finally to those front line management employees at the regional office and local operating subsidiaries. Each phase was initiated, thoroughly studied and analyzed, and rolled out to the employees in the communications to in the attachments to LFUCG1-question #19 while the wrap of the prior phase of the reorganization was being completed.

24. b. The reorganization began on Mr. Pelczer's election of President. As stated in the his letter of November 19, 2003 (KAW_R_LFCDR#19_attachment1_062504, page 1 the initial roll out of the reorganization plan was the culmination of a six month project to develop a sinning Strategy that had been thoroughly tested and reviewed by leaders across American Water. The reorganization was originally scheduled for completion by July, 2004, but due to the sheer magnitude of the undertaking the final organization will not be complete until mid-August, 2004.

24. c. The reorganization is not expected to impact the level of employees other than the changes included in the forecasted test-year. Mr. Rowe has now been elected President to replace Mr. Mundy, Mr. Jarrett will continue in his role as Chairman of the Board of Directors as described in his testimony. Mr. Rowe and Mr. Jarrett will be reporting to the new regional office in Hershey, PA.

24. d. KAWC has not projected the results of the reorganization in its forecasted test-year for the final result of that effort is not known at this time. The Company has included the level of employees that it expects to have to carry out the operations of KAWC during the forecasted test-year.

24. e. KAWC does not have the breakdown of cost savings from the reorganization or the transitions costs for severance, moving expenses, and employee evaluations, etc. at this time. After the reorganization is in place, the Company will supply the final estimates of any savings as well as the transition cost required to generate those savings.

24. f. Please refer to current organization charts attached as the exhibits to question 22 above. Please see KAW_PSCDR3#24f_attachment_080604.pdf for pre-reorganization organization charts.

Witness Responsible:

Michael A. Miller

25. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information Requests, Item 76(a). Provide itemized descriptions for each entry recorded on this schedule.

Response:

The majority of the entries on KAW_R_PSCDR2#76_attachment1_062504 originate with the American Water Works Service Company bill. The start up of the Call Center involved consulting fees, facility start-up costs, service company labor charges for employees all across the system who were assigned duties to work on the start-up and transition to the National Call Center, travel expenses and a myriad of other miscellaneous expenses associated with the undertaking.

December 2003 - Service Company charges

November 2003 – The entry for $53,758.05 was for severance costs of the employees at KAWC. The remaining two entries were for Service Company charges.

October 2003 – Service Company charges

September 2003 – Service Company charges

August 2003 – Service Company charges

July 2003 – Service Company charges

June 2003 – Service Company charges

May 2003 – Service Company charges

April 2003 – Service Company charges

March 2003 – Service Company charges

February 2003 – Service Company charges

January 2003 – Service Company charges

December 2002 – Service Company charges

Michael A. Miller

Witness Responsible:

November 2002 – Service Company charges

October 2002 – The amount of $458,491.59 was to transfer the amounts previously deferred to this account number. The amount included both Service Company charges, but also included KAWC labor charged to the previous account for time spent on identifying KAWC conversion issues and developing the transition plan. The remaining charges for this month were for Service Company charges.

September 2002 – Service Company charges

August 2002 – Service Company charges

July 2002 – Service Company charges

June 2002 – Service Company charges

May 2002 – Service Company charges

April 2002 – Service Company charges

March 2002 – Service Company charges

February 2002 – Service Company charges

January 2002 – Service Company charges

Witness Responsible:

Michael A. Miller

26. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information Requests, Item 76(b) and the Direct Testimony of Michael A. Miller, Exhibit MAM-5 at 2-3.
    a. Explain where the detailed items shown on Exhibit MAM-5 at 2-3 are included in the schedule provided in Kentucky-American's Response to Item 76(b).
    b. Explain why the call center cost shown in Kentucky-American's Response to Item 76(b) is $706,244, but the amount included on Workpaper 3-5 at 1 as call center expenses for the forecasted period is $831,065.

Response:

a. The schedule attached to 76(b) provided the basis for the amortization of the call center transition costs based on the original estimate which was developed on 2000 costs. The costs savings items included in MAM pages 2 & 3 of 5 are based on forecasted 2005 costs. The Cost Components on exhibit MAM-5 and response to 76(b) are essentially the same but the timeframes (2000 and 2005) are different.

b. The schedule attached to 76(b) provided the basis for the amortization of the call center transition costs based on the original estimate which was developed based on 2000 costs. The Company began to amortize the transition costs based on this original estimate of savings, as provided in the response to 76(b), once it moved to the call center in late 2003. The monthly amortization of $8,900 was developed by dividing the $106,941 shown in the response to 76(b), by 12. The forecasted amount of $831,065 is the level of projected costs for 2005.

Witness Responsible:

Michael A. Miller

27. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information Requests, Item 76 (c). Provide itemized descriptions for each entry recorded on this schedule.

Response:

The Service Company system used for 2002 and 2003 provides more detail than previous years. The information for 200 and 2001 is provided but not to the degree of the current system. Please see attached file KAW_R_PSCDR3#27_080604.pdf.

Witness Responsible:

Michael A. Miller

28. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information Requests, Item 76(d) and the Direct Testimony of Michael A. Miller, Exhibit MAM-5 at 4-5.
    a. Explain where the detailed items shown on MAM-5 at 4-5 are included in the schedule provided in response to Item 76(d).
    b. Explain why the shared service center shown in the response to Item 76(b) is $434,108, but the amount included on Workpaper 3-5 at 1 as shared service center expenses for the forecasted period is $448,017.

Response:

a. The schedule attached to 76(d) provided the basis for the amortization of the shared service center transition costs based on the original estimate which was on 2000 costs. The cost savings items included in MAM pages 4 & 5 of 5 are based on forecasted 2005. The Cost Components on exhibit MAM-5 and the response to 76(b) are essentially the same but the timeframes (2000 and 2005) are different.
b. The schedule attached to 76(b) provided the basis for the amortization of the shared service center transition costs based on the original estimate which was developed based on 2000 costs. The Company began to amortize the transition costs based on this original estimate of savings, as provided in the response to 76(b), in late 2002. The monthly amortization of $13,417 was developed by dividing the $161,445 shown in the response to 76(b), by 12. The forecasted amount of $448,017 is the level of projected costs for 2005.

Witness Responsible:

Michael A. Miller

29. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information Requests, Item 77.

    a. Provide copies of the orders as originally requested.

    b. Provide all written communications, including internal memoranda, correspondence, and electronic mail messages, between Mr. Miller and the other VP/Treasurers and Directors of Rates in AWWC referenced in this response.

Response:

a. Please refer to the attached copies of the orders identified as
KAW_R_PSCDR3#29a_attachment_CA_080604.pdf
KAW_R_PSCDR3#29a_attachment_IL_080604.pdf
KAW_R_PSCDR3#29a_attachment_IN_080604.pdf
KAW_R_PSCDR3#29a_attachment_MO_080604.pdf
KAW_R_PSCDR3#29a_attachment_NJ_080604.pdf
KAW_R_PSCDR3#29a_attachment_NM_080604.pdf
KAW_R_PSCDR3#29a_attachment_PA_080604.pdf
KAW_R_PSCDR3#29a_attachment_TN_080604.pdf
KAW_R_PSCDR3#29a_attachment_VA_080604.pdf
KAW_R_PSCDR3#29a_attachment_WVA_080604.pdf

As indicated in the response to PSC2#77, many of the orders were the result of stipulated cases and do not address the specific rate treatment permitted for the call center or shared service center.

Witness Responsible:

Michael A. Miller

b. Please refer to KAW_R_PSCDR3#29b_attachment_080604.pdf. Mr. Miller takes part in regular meetings with the other VP Finance and Directors of Rates in the other American Water subsidiaries, and a great deal of his understanding of the discussions that occur in these meetings.

Witness Responsible:

Coleman D. Bush

30. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information Requests, Item 82(c).

    a. Explain how, given that Kentucky-American limits the allocation of costs to Tri-Village Water District ("Tri-Village") and Elk Lake Homeowners Association ("Elk Lake") to one-third of the identifiable costs, its Central Division customers will benefit from the spreading of costs over a larger customer base.

    b. Provide all correspondence between Kentucky-American and Tri-Village regarding the purchase of Tri-Village's assets.

    c. Provide all internal correspondence, memoranda, notes, and electronic mail messages in which the purchase of Tri-Village's assets is discussed.

    d. Provide all correspondence between Kentucky-American and Elk Lake regarding the purchase of Elk Lake's water distribution system.

    e. Provide all internal correspondence, memoranda, notes, and electronic mail messages in which the purchase of Elk Lake's water distribution system is discussed.

Response:

a. Even at one-third, a portion of the costs that were borne completely by Central Division ratepayers will be allocated to the Northern Division rates and will not be included in the rates of the Central Division.

b. See attachment KAW_R_PSCDR3#30b_attachment_080604.pdf.

c. See attachment KAW_R_PSCDR3#30c_attachment_080604.pdf.

Witness Responsible:

Coleman D. Bush

d. See attachment KAW_R_PSCDR3#30d_attachment_080604.pdf.

e. See attachment KAW_R_PSCDR3#30e_attachment_080604.pdf.

Witness Responsible:

Michael A. Miller/Linda Bridwell

31. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1, Workpaper 1-12 at 2.

    a. Provide a detailed analysis of the cost of the Elk Lake acquisition in the amount of $107,432.
    b. State whether the $107,432 represents the cost to acquire the Elk Lake system.
    c. If the $107,432 does not represent the cost to acquire the Elk Lake system, state whether it represents the utility plant acquisition adjustment originally recorded and marked through in the journal entry provided in Kentucky-American's Response to Commission Staff's Second Set of Information Requests, Item 83(a).
    d. Refer to Kentucky-American's Response to the AG's First Request for Information, Item 108, and Application, Exhibit 37-B of at 2. State whether Kentucky-American has overstated Elk Lake's rate base by $100,941. Explain.
    e. Provide a detailed analysis of the cost of the Tri-Village acquisition of $227,262.

Response:

a. The $107,432 referred to in the Data Request was revised to $112,497 as shown on the attachment to the response to the Commission Staff's Second Set of Information Requests, Item 82 (a), page 2 of 2. A detailed analysis of the $112,497 is attached as KAW_R_PSCDR3#31a_attachment_080604.pdf.
b. No.
c. No, the utility plant acquisition adjustment originally recorded was $112,497. The mark through represented a correction to the journal entry. Please note that the difference of $5,065 is in the amortization of Tri-Village represented as $227,262 at W/P 1-12, page 2. The actual utility plant acquisition adjustment recorded for Tri-Village was $222,197 as reflected in the response to the Commission Staff's Second

Witness Responsible:

Set of Information Requests, Item 82 (a).

d. Yes, the deferred debits for Elk Lake are overstated by $103,179.42 for the base period, $99,598.30 for the forecasted period, and $100,941 for the thirteen month average. They were overstated because they were inadvertently picked up as both a deferred debit and a utility plant acquisition adjustment on the rate base schedule.

e. The actual acquisition adjustment was $222,197. Please refer to the attachment KAW_R_PSCDR3#31e_attachment_080604.pdf.

Witness Responsible:

Coleman Bush

32. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information Requests, Item 82(a) at 2. Provide the journal entry for the acquisition of Tri-Village in the same format as the Elk Lake journal entry.

Response:

See the attached journal entry.

For the electronic version, please refer to KAW_R_PSCDR3#32_attachment_080604.pdf

Witness Responsible:

Rich Svindland

33. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information Requests, Item 85(e). The response is not responsive. For each of the three locations identified, provide the amount of security costs projected for the forecasted period and included in forecasted operating expenses, the expense accounts charged, and the name of the vendor providing the security services.

Response:

Based on the completion of the EPA required Vulnerability Assessment (VA) in March 2003, and the worked started on the EPA required Emergency Response Plans (ERPs), Kentucky American Water (KAW) was able to scale down the three locations listed in the response to Commission Staff's Second Set of Information Requests, Item 85(a) to two locations. At the same time, KAW changed from off-duty Lexington Police Officers to guard services provided by Murray Guard. The two locations manned by Murray Guard are KAW's office building lobby and the main gate to the Richmond Road Water Treatment Plant and Office complex.

The security costs in the forecasted period are not budgeted by location. The total combined cost for the two locations in the forecasted period is $11,201 per month. These costs are strictly for the continued use of Murray Guard and their KAW supplied cell phones. Beginning in the first month of the forecasted period, the costs will be charged to account 120205.57511.16 as reflected on W/P 3 –13 page 3 of 7.

Witness Responsible:

Kenneth Rubin

34. Refer to the Direct Testimony of Kenneth Rubin, Schedule 3, and Kentucky-American's Response to Commission Staff's Second Set of Information Requests, Item 86(a). In the period from August 12, 2001 to September 19, 2003, Kentucky-American spent $2,180,259, or approximately $1 million annually, on security guards at three locations. It currently projects that only $134,412 will be spent of security guards during the forecasted test period. a. State the reason for the reduction in the level of security guard costs between the deferral and the forecast periods. Provide a comparison between the daily costs incurred during the deferral period and the projected costs in the forecasted period. b. State the reasons for Kentucky-American's delay in implementing the changes in its security guards that resulted in the reduced costs.

Response:

(a) For a large part of the deferral period, Kentucky-American Water posted security guards at three locations: Lock and Dam Number 9 on the Kentucky River, the Kentucky River Water Treatment Plant, and the Richmond Road Water Treatment Plant. In the forecast period, guards will be posted at only two locations. In addition, the unit cost of off-duty City of Lexington police guards, which were employed for a large part of the deferral period, was higher than the unit cost of guards which will be supplied by Murray Guard during the forecast period. Accordingly, in the deferral period (9/12/01-12/31/04), guard costs averaged $1,957 a day. In the forecast period, guard costs are expected to average $11,201/month (or roughly $373/day).

(b) Kentucky-American Water changed its guard service and the number of guards once it had conducted its own analysis of the vulnerability of its operations to terrorist threats and installed or otherwise implemented sufficient countermeasures to reduce risks associated with these vulnerabilities to the point that high-level police guards were no longer needed to reasonably assure that its operations were protected.

Witness Responsible:

Michael A. Miller/Linda Bridwell

35. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information Requests, Item 92, and Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1, Workpaper 1-12 at 1. In its Order of May 9, 2001 in Case No. 2000-00120,[1] the Commission allowed Kentucky-American an annual amount for community education costs of $96,316 for the purpose of "developing more extensive conservation efforts." Explain why, as Kentucky-American has included $146,000 in its forecasted expenses for conservation efforts, it is reasonable or necessary to continue the amortization of community education costs.

Response:

Kentucky American Water understood the Commission's Order of May 9, 2001 to allow the amortization of Community Education costs as the recovery of a prior investment to be included in rates until fully amortized. In addition, the Company is seeking in rates its expanded ongoing community education costs concerning conservation as it was ordered to do. The Order in case 2000-120 required to file a written plan (which it did) within 60 days of the Order describing the additional conservation efforts that will be made. The Company believes it is appropriate to recover both the previously approved amortization of the deferred expense approved in case 2000-120 and to recover it ongoing expanded conservation education cost as outlined in the written report required by the Commission.

Witness Responsible:

Michael A. Miller

36. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information Requests, Item 93. The response was not responsive. 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:

As was stated in the response to Item 93 of the Public Service Commission's Second set of information requests, the Company has performed no studies of this issue. Also, the Company is not in possession of the incentive plans of other utilities. However, the Company has requested a consultant to provide from their existing databases information regarding the prevalence of incentive plans in the utility industry. The response to that request is attached.

The Company cannot commit to providing copies of other utility incentive plan information or summaries of such information, as it may not be available to the Company. Such information as is available to our consultant from other utilities, which contains identifying information, is not available to the Company. The consultant has indicated the Company could retain them to prepare a report containing comparative information from their database without providing identification of individual utilities. Also it is possible to retrieve certain incentive plan information for certain employees of publicly traded utilities from proxy statements filed with the SEC. The Company has not attempted to retrieve such information as it would require additional work effort, and the information would be of limited value.

Please see attached file KAW_R_PSC3#36_attachment_080603.

Witness Responsible:

Sheila Valentine

37. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information requests, Item 96.

    a. Explain why the referenced testimony included the statement that "Monthly system delivery is projected by considering a five-year monthly history of pumpage. This may be adjusted based on judgement concerning future events."
    b. Calculate a forecasted fuel and power expense using the 5-year monthly history of pumpage and compare it to the amount included in the application. Provide all workpapers, state all assumptions, and show all calculations used to prepare this response.
    c. Calculate a forecasted chemical expense using the 5-year monthly history of pumpage and compare it to the amount included in the application. Provide all workpapers, state all assumptions, and show all calculations used to prepare this response.

Response:

a. While I had reviewed the fuel and power forecast for reasonableness, I was unaware that this aspect of the process had changed from the method used in the past.
b. See the attached schedules detailing the 5 year pumpage history and recalculation of fuel and power.
   For the electronic version see KAW_R_PSCDR3#37_attachment1_080604.pdf
c. See the attached schedule recalculating the chemical expense.
   For the electronic version see KAW_R_PSCDR3#37_attachment2_080604.pdf

Total forecasted system delivery has not changed. I redistributed forecasted system delivery between the Kentucky River Station and the Richmond Road Station based on a five-year history (1999-2003) of pumpage. Further, I redistributed pumpage by month per station

Witness Responsible:

Sheila Valentine

based on a five year history (1999-2003) of pumpage by month per station. Because the estimates used for KWH per million gallons and pounds of chemical per million gallons vary by month, there was some impact to the forecast by using the five-year history. The differences in the original filing versus the recalculation are as follows:

	Original filing	Recalculation	Difference
Fuel and Power	1,922,641	1,921,036	(1,604)
Chemicals-Central	1,220,296	1,223,953	3,657
Chemicals-Tri Village	840	840	0

Witness Responsible:

Sheila Valentine

38. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information requests, Item 98(c). For each chemical listed, provide the percentage price increase for each year in the period 1999 and 2003.

Response:

Chemical	Price Increase 1999	Price Increase 2000	Price Increase 2001	Price Increase 2002	Price Increase 2003
Polyaluminum Chloride (PACL)	1.07%	6.00%	-30.49%	-2.20%	1.67%
Chlorine	-21.01%	0.47%	7.92%	-23.60%	61.68%
Fluoride	-2.70%	5.20%	2.91%	-65.59%	-29.62%
Carbon	100.00%	23.26%	-5.27%	5.67%	1.01%
Copper Sulfate	100.00%	-4.81%	0.02%	-45.75%	165.48%
Polymer - 1	-13.30%	-7.90%	-11.38%	-13.47%	-1.50%
Ammonia	0.42%	-1.33%	2.99%	9.88%	3.77%
Caustic Soda (sodium hydroxide)	7.14%	-33.46%	56.58%	-23.64%	-27.36%
Potassium Permanganate	-0.27%	-0.16%	5.94%	1.35%	0.30%
Polymer - 2	-8.77%	-14.91%	5.32%	-26.70%	-8.83%
Ferric Chloride	-1.17%	2.00%	12.39%	-12.61%	-49.55%
Corrosion Inhibitor (zinc)	5.75%	-3.71%	-4.86%	-1.83%	-12.48%

Witness Responsible:

Sheila Valentine

39. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information requests, Item 99(b).

    a. State when the Richmond Road Station was last cleaned.

    b. When a cost is nonrecurring, the Commission has generally either removed the expense from test-period operations or amortized the cost over its estimated useful life. Explain why the cost to clean the Richmond Road Station Plant should be treated in a different manner.

Response:

a. Richmond Road Station was last cleaned in August 2002.

b. After further discussions with the production staff at Kentucky American Water and given the current water quality conditions and treatment processes, the Company is forecasting that these cleanings will be an annual expense and should be included in this rate filing.

Witness Responsible:

Sheila Valentine

40. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information requests, Item 99(d). Provide a schedule listing each cost included in the annual numbers for each treatment plant.

Response:

See attached detail for Kentucky River Station and Richmond Road Station. For the electronic version refer to KAW_R_PSCDR3#40_attachment_080604.pdf

Witness Responsible:

Sheila Valentine

41. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information requests, Items 52 and 96. Explain why, if the labor capitalization rate for the forecasted test period is 20.9 percent, 19.53 percent should be used to capitalize group insurance.

Response:

The labor capitalization rate and the capitalized group insurance premium rate are two separate calculations. Labor costs that are charged directly to capital constitute the capitalized labor and that rate is a percentage of total labor costs. The group insurance premium capitalized credit is a calculation of the effective overhead rate for group insurance. This amount is added to capitalized labor as one part of the capitalized overheads and a reduction to expense.

Witness Responsible:

Sheila Valentine

42. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information requests, Item 104.

    a. Provide the 2004 Towers and Perrin report when completed

    b. When the 2004 report is completed, estimate the effect the 2004 Report will have on the forecasted pension expense. Provide all workpapers, state all assumptions, and show all calculations used to derive the estimate.

Response:

The 2004 Towers and Perrin report will not be complete until mid to the end of November 2004.

Witness Responsible:

Michael A. Miller

43. Provide Kentucky-American's depreciation plant schedule including original costs of the assets, estimated salvage values, estimated cost of removal, depreciation lives, accumulated depreciation and depreciation expense for the forecasted test period.

Response:

The original cost of utility plant in service is shown on Schedule B 2.1, beginning with Page 3 of 8 through Page 8 of 8. The estimated salvage values, estimated cost of removal and depreciation lives are included in the depreciation rates as determined in the last depreciation study. The Company does not separate the salvage values, cost of removal and depreciation lives as reflected in the Company's forecasted depreciation expense. The accumulated depreciation is shown on Schedule B-3 Pages 1 through 12. See attached file KAW_R_PSCDR3#43_attachment_080604.pdf for Central, Tri-Village and Elk Lake depreciation expense requested.

Witness Responsible:

Mike Miller

44. Refer to Kentucky-American's Response to Commission Staff's Second Set of Information Requests, Item 115. Recalculate the effect of the slippage factors on the forecasted revenue requirement, rate base, and cost-of-service study without correcting the contribution in aid of construction error. Provide all workpapers, assumptions, and calculations showing the effect of the slippage factors on each forecasted element of rate base and the cost-of-service study.

Response:

See attached schedules. For the slippage adjustment workpapers to the utility plant additions, see KAW_R_PSCDR2#115_PLANT_062804.pdf pages 1 through 126.
For the electronic format of all other workpapers refer to KAW_R_PSDCR3#44_attachment_080604.pdf

	Original Filing	**PSC Slippage**
Revenue increase	$ 7,297,443	$ 7,176,819
Rate Base	158,958,817	158,063,617
Overall return	8.25%	8.25%
AFUDC	470,940	417,280
Property taxes	2,223,673	2,221,770
Depreciation	7,065,762	7,045,716

Witness Responsible:

Michael A. Miller

45. State when Kentucky-American plans to undertake a new depreciation study.

Response:

The Company's last depreciations study was addressed in Case No. 95-554. The Company would anticipate filing a depreciation study before filing its next rate case, so that the results of that study could be incorporated into that case.

Witness Responsible:

Coleman D. Bush

46. In its response to Community Action Council's First Request for Information, Item 4, Kentucky-American states that it does not track the information requested in the second part of the interrogatory.

    a. List the categories that Kentucky-American does track.

    b. (1) Explain why re-connects, new accounts, new customer accounts, and old customer new address accounts are not tracked.

       (2) Explain why tracking such actions would not be beneficial to Kentucky-American.

Response:

The second part of the Community Action Council's First Request for Information, Item 4, asks, "….what is the extent of duplication (e.g., same customer more than one service activation, and same meter more than one service activation) within this estimate?"

What the response was intended to say is that while the Company does track service orders by numerous actions, it does not keep track of multiple service activations for the same customer or same meter.

a. Please refer to attachment KAW_R_PSCDR3#46_attachment_080604.pdf for a list of order types that the Company does track. The attachment shows the types of orders formerly tracked under our previous Customer Information System ("CIS") and the types of orders now tracked with our current CIS. The list of orders tracked has expanded significantly.

b. (1) The only type of action not specifically tracked is "old customer new address." Some of the important reasons for tracking order types are work

Witness Responsible:

Coleman D. Bush

scheduling and process improvement. In establishing the list of order types to be tracked, perhaps the team making the final selection did not see the value of tracking this type of information or perhaps the team did not think of tracking this type of information.

(2) Tracking this and other types of actions could prove beneficial in better allocating costs that are now borne equally by all ratepayers to the cost causers.

Witness Responsible:

Michael A. Miller

47. In its response to the Community Action Council's First Request for Information, Item 6, Kentucky-American states that, "[t]he Company made the decision to propose a 25% discount on the service charged based on review of programs in other states as well as tariffs in place or being proposed in other jurisdictions for its sister companies."

    a. Identify each program that Kentucky-American reviewed and state the name of the utility conducting the program.
    b. Describe how Kentucky-American determined that 25 percent discount on the service charged was the best method to assist low-income families.
    c. Identify and describe each option that Kentucky-American considered in its effort to assist low-income families.
    d. For each option listed in Item 47(c), state why Kentucky-American chose not to implement that option.
    e. State whether Kentucky-American considered giving low-income families a percentage decrease in their usage rates.
    f. State the dollar amount of discount that a qualifying customer (low income) can expect to receive based on the current rates and the proposed rates.

Response:

a. KAWC reviewed the tariff approved for Pennsylvania American, and the tariff filed in the current rate case of West Virginia American.

b. KAWC mirrored the tariff from the original tariff approved for PAWC, and the tariff currently proposed for WVAWC. In discussions with the President, VP Finance and Director of Rates for PAWC, the Company learned of the low income tariff in place for PAWC, and the manner in which it was implemented and operated. Based on these discussions, and the positive reaction and impact the PAWC tariff had experienced, the Company elected to propose a similar tariff for KAWC.

Witness Responsible:

Michael A. Miller

c. In addition to the PAWC tariff and the proposed tariff for WVAWC, KAWC was aware of low income assistance programs in other states that apply to energy utilities (electric and gas). The low income energy assistance programs of which the Company is aware are funded partially by the federal government, and in West Virginia were created legislatively to include additional assistance from the state government. In a discussion with the Consumer Advocate Division of WV regarding the low income water tariff filed there, we were asked to look at the low income assistance plan in place in Ohio, but as yet have not had the opportunity to do so.

d. The Company elected to file the low income tariff in KAWC because it wished to propose a simple and easily implemented tariff in this case. The Company was not in a position to address a low income assistance plan through the legislative process at this time, and that was the only other type of low income program of which the Company was aware.

e. No. The Company elected to propose only a discount on the service charge based on its knowledge of the approved tariff for PAWC and the proposed tariff for WVAWC.

f. Low Income Discount for a residential customer with a 5/8 inch meter:

Central Division -	Current-$1.83	Proposed-$2.11
Tri-Village-	Current-$4.85	Proposed-$6.80
Elk Lake-	Current-$5.24	Proposed-$7.43

Witness Responsible:

Coleman D. Bush

48. In its response to the Community Action Council's ("CAC") First Request for Information, Item 7, Kentucky-American states that it has no objection to the Administrator of the Water for Life program using those funds for the purpose of paying the Activation Fee (if approved), if he determines a customer needs assistance with this fee.

    a. State whether Kentucky-American intends to contribute additional funds of its own to assist in offsetting this possible need.
    b. State whether the $30,000 generated by this program is enough to handle all types of requests to the Administrator of the fund by those qualifying for assistance.
    c. Describe the assistance that Kentucky-American would provide these individuals if the level of funding to the program is insufficient.

Response:

a. The Company has budgeted the same level of contribution for 2005 as it did in 2004.
b. The Company has been advised by a Community Action Council representative that due to the timing of the receipts into the fund, there were times when there were no funds available during 2003. Based on that history, it can be questioned if the money generated by the program is enough to handle all types of requests to the Administrator of the fund by those qualifying for assistance.
c. The Company would provide the same assistance that would be available to any customer including hidden leak adjustments, bill extensions and payment plans.

Witness Responsible:

Michael A. Miller

49. In its response to the Attorney General's ("AG") First Request for Information, Item 4(f), Kentucky-American states that, "[t]he details [of administering and accepting applications by mail] have not been fully worked out but if CAC is agreeable, it would appear reasonable that certification could be obtained in this manner barring some problem or question about the information required direct contact."

a. State whether Kentucky-American intends to develop in conjunction with CAC an application form to disperse to their customers inquiring about the availability of the Low Income Program (Water for Life Fund).

b. State whether Kentucky-American already has available these forms pre-addressed (to CAC) concerning the availability of the Low Income Program (Water for Life Fund).

c. State whether Kentucky-American plans to have pre-addressed (to CAC) application forms available to mail, distribute or otherwise make available to customers inquiring about the availability of the Low Income Program (Water for Life Fund).

d. State the cost to the applicant to participate in this program.

Response:

There seems to be some confusion between the Low Income Tariff, the subject of AGKYDR1#4, and the Water for Life Fund. These are separate issues. We assume this question refers to the Low Income Tariff and have prepared our response accordingly.

a. If the Low Income Tariff is approved, the Company will most likely use a bill message or bill insert to communicate with its customers regarding the availability of this tariff.

Witness Responsible:

Michael A. Miller

b. Kentucky-American Water Company does not have any forms available at this time concerning the Low Income Tariff.

c. We did respond to AGKYDR1#4 by saying that we have no objection to certification by phone or by mail if that fits the guidelines of the Community Action Council ("CAC"). While we have met with the CAC, we have not determined if certification can actually be accomplished by phone or mail. In order to utilize the services provided by the CAC a person or family must be certified by the CAC that he or she (or that family) meet the Federal poverty guideline. Our current plan is to approach certification in two ways. All of our customers in the CAC database would be coded for the low income tariff (assuming approval by the Commission). Again, the details need to be completed, but we envision updating our records on a routine basis once a system to receive changes from the CAC has been established. The other way certification would be approached is through the use of the bill message or insert mentioned above. Customers who contact us about this program and who are not currently in the CAC database would be directed to the CAC in person or by phone or mail, if possible, to determine if they can be certified. They would then be coded for the low income tariff once we receive the update from the CAC database.

d. There would be no cost to the applicant.

Witness Responsible:

Coleman D. Bush

50. In its response to the AG's First Request for Information, Item 23, Kentucky-American states that, "field costs are only part of the cost used to develop the activation fee. The fee also includes, among other costs, office costs to set up the account."

   a. Explain why cellular phone service is allocated to this fee.
   b. Explain why, if the supervisor has sorted these "requests" by route, a cell phone expense is necessary.
   c. Explain why the employee responsible for providing this service would not be able to find the location without the use or necessity of a cell phone.
   d. Explain why the cost allocated should be $2,294 and not $0.00. (The $2,294 is the calculation using the "factors" devised by the Company applied to a total of $18,363.)
   e. Explain why Miscellaneous Operator Service expenses are allocated to this fee.
   f. What would this be for and why should there be $12,783 after using the "factors" devised by the Company applied to the total of $119,381?
   g. Explain how Kentucky-American devised all "factors" used in the allocation of costs, mileage, customer calls, etc. in relation to this activation fee.

Response:

Kentucky American Water assumes the reference to be the response to Item 5 as Item 23 relates to the additional cost of reading meters during implementation of the Emergency Pricing Tariff.

a. The field service personnel who initiate service are part of the Distribution Department as are the inside customer service personnel. Cell phones in this department are provided for all Distribution Department supervisors and several union employees, including field service personnel who perform stand-by duties or

Witness Responsible:

Coleman D. Bush

require frequent contact with customers during the day that cannot be efficiently handled through the dispatcher or local customer service representatives. While the supervisors are generally assigned to a particular function or functions, in reality they support all aspects of the department whether it be performing stand-by duty or filling in for another supervisor on vacation. Total cell phone expense for the Distribution Department has been allocated based on a ratio of direct labor dollars involved with direct customer service work to total labor dollars in the Distribution Department.

b. We frequently turn on new service in the evening, when there is no radio contact with the office, and from time to time it is necessary to contact the Call Center to get information that might be helpful in locating a meter if part of the needed information is missing or if an error has been made in taking the order. An order that is often worked at night is a second trip to turn on service when service could not be turned on at the first trip because water continued to run. It is helpful to contact the customer in these cases before making the trip to make sure that he or she will be home so that the source of the running water can be identified and service turned on. There are times when it is necessary for the Call Center to contact the field service person to change a turn on order that is already in the system or to reschedule an appointment.

c. There are times when the information on the order is simply not adequate to make the correct identification of the premise so that the needed work can be performed. In multi-unit buildings where each unit is metered, finding the correct meter can be a challenge that at times can only be overcome with the assistance of customer service representatives and the records available to them or by a call to the customer.

d. The actual allocation of cell phone expense is $4,966. Refer to the attachment to this response KAW_R_PSCDR3#50_attachment1_080604.pdf. The handwritten notes

Witness Responsible:

Coleman D. Bush

included in the attachment are perhaps the best way to illustrate the method of allocation. The approach we took in developing the activation fee was to arrive at the overall cost of working a service order, whether it is a turn-on, a shut off or any other type of service order. Cell phone expense is part of the overall cost of working service orders including service initiation orders. As such, 23.97% or $4,224 of general Distribution Department cell phone costs have been applied to working service orders and 100% or $742 of cell phone expense for the inside customer service group have been applied to the cost of working service orders.

e. Misc Oper (miscellaneous operating expense) includes office supplies, training costs, overtime meals, safety shoes and equipment, small tools, meter reading equipment, travel and many of the other day to day expenses that are involved in operating the Distribution Department of the Company. This account includes direct expenses for service order work as well as overhead expenses for service order work. Since all department employees, including the field service personnel involved directly in service order work, use or benefit from the use of some or all of these expenditures, the Company believes that the best method to allocate these costs to the cost of working service orders is on the basis of labor dollars.

f. We are unable to reconcile the $12,783 figure as requested. M & S (materials and supplies) Oper (operating expense) included in miscellaneous expenses is $114,418. 23.97% or $27,426 of this expense has been allocated to the cost of working service orders. The $119,381 figure identified represents adding the $4,963 for Misc Oper (miscellaneous operating expense) Customer Service to the $114,418. A more detailed explanation of the method used to allocate this and other costs is included in the response to subpart g. of this request.

g. Please refer to attachment KAW_R_PSCDR3#50_attachment2_080604.pdf filed with this response.

Witness Responsible:

Coleman D. Bush

51. In its response to the AG's First Request for Information, Item 23, Kentucky-American states that, "[a]ccording to CAC representatives, depending on the timing of receipts into the fund, there were times when there were no funds available during 2003."

a. Describe how contributions from the stockholders are deposited into this fund.

b. State whether Kentucky-American has developed any method to prevent the Water for Life Fund from being depleted before the next deposit is made.

c. State whether Kentucky-American has considered increasing its assistance to this fund.

d. State whether Kentucky-American has devised a public education campaign to bring awareness to the need for assistance for low-income families.

Response:
a. The Company sends a check to Community Action Council.

b. No.

c. The Company's budgeted contribution for 2005 is $5,000 and has not been increased from the amount contributed in 2004.

d. The Company sends an annual bill insert concerning the Water for Life Fund. See attachment KAW_R_PSCDR3#51_attachment_080604.pdf for a copy of the 2004 bill insert. Also, the Company maintains promotional material on the Fund in lobby at 2300 Richmond Road.

Witness Responsible:

Michael A. Miller

52. In its response to the AG's First Request for Information, Item 14, Kentucky-American states that, "[t]he Company is not seeking approval of this tariff but simply notifying the PSC that it supports economic development and would like to support efforts in an incentive tariff once the source of supply solution is implemented."
    a. State whether Kentucky-American intends to withdraw the tariff contained in its application.
    b. Describe Kentucky-American's efforts to support economic development prior to the filing of its application in this proceeding.

Response:

a. The Company did not include the tariff in its filing but was simply notifying the Commission of its intent to do so in a future case once the solution to the source of supply issue is in place.
b. The Company participates in several community organization that promote economic development such as: (1) Chamber of Commerce, (2) trade shows, (3) Kentucky Industrial Council , and (4) Kentucky Infrastructure Authority.

Witness Responsible:

Michael A. Miller

53. In response to Commission Staff's Second Set of Information Requests, Item 5, Kentucky-American states that, "KAWC has informed Dr. Vander Weide that it is not proposing the Emergency Pricing Tariff in this proceeding." State whether Kentucky-American intends to withdraw the Emergency Pricing Tariff from its application in this proceeding.

Response:

There was a misunderstanding of the information provided to Mr. Vander Weide. Please see response to KAW_R_LFCDR2#53_080604. The Company is not withdrawing its "Emergency Pricing Tariff."

Witness Responsible:

Coleman D. Bush

54. In its response to the AG's First Request for Information, Item 23, Kentucky-American states that, "once the Company enters the rationing phase of its DMP it envisions more frequent meter readings with the mailing of an interim notice that would alert customers that a change in demand may be necessary to avoid paying the approved emergency pricing tariffed rates."

    a. Explain why Kentucky-American failed to describe a "dramatic increase in costs" statement.
    b. Explain why an increase in meter readings and costs would be necessary.
    c. State whether Kentucky-American is of the opinion that customers would fail to curtail their water usage if the meters were only read once per month. Explain.

Response:

a. The Company attempted to describe the "dramatic increase in costs" statement by saying that "it envisions more frequent meter readings with the mailing of an interim notice," but now recognize that some cost estimates would better describe the increase in costs.

   In the event that we enter the Rationing Phase of our Demand Management Plan and initiate twice-monthly meter readings in order to send a timely price signal to our customers, we estimate the following additional costs during this time (stated on a monthly basis – 21.7 days per month).

   Temporary meter readers – 14 @ $13.90 per hour - $33,782.56
   Travel – (300 miles per day) - @ $.375 per mile - $2,441.25

Witness Responsible:

Coleman D. Bush

Start-up and miscellaneous:

Training – (5 days) - $7,784.00

Small tools and equipment - $3,000.00

Meter reading equipment (purchase costs listed, but the Company would attempt to lease or borrow):

DAP PC9800 hand held meter reading devices – approximately $1,500 each

Touch pad readers – approximately $700 each

We would share as many vehicles as we could to save vehicle leasing costs and would have readers dropped and picked up at certain locations, so we would need to provide communication in some cases in the form of additional company radios or cell phones.

Also, we are currently working with our software consultants to provide pricing on a modification that would allow us to send an interim notice to our customers. That cost estimate is still in development and will be provided when available.

b. The most recent experience that we have with a drought occurred in 1999 when the Company entered the Full Alert Phase of its Demand Management Plan. Under the Full Alert Phase, all nonessential water usage is restricted, including the elimination of all lawn watering, vehicle washing other than commercial establishments, filling of private residential pools and the use of or filling of ornamental fountains. The graph attached as KAW_R_PSCDR3#54_attachment_080604.pdf depicts customer demand around certain key events during this drought. From the graph, one can see customer reaction to certain events in the form of changes in demand. While there are many factors that will influence demand it can be seen that immediately after a

Witness Responsible:

Coleman D. Bush

key event, customer demand drops sharply followed soon by an increase in demand indicating at least on one level that notification does cause customers to change their immediate demand habits however as attention slips the demand reductions tend to gradually go back up. If the Company ever enters the Rationing Phase of its Demand Management Plan, the community will in essence be in a state of emergency. Every reasonable means will need to be taken to reduce nonessential customer demand so that essential demands can be met. Interim meter readings will send a price signal with which a customer can make his or her own decisions about discretionary use of water and will also alert us and the customer as soon as possible to plumbing leaks and other hidden uses of water, and it will help reinforce the critical nature of the situation. Water will be saved and customers will avoid extremely high water bills, which are joint goals of the Emergency Pricing Tariff.

c. The Company believes that customers will curtail their water use as demonstrated by the response to the various events in 1999. The Company also believes that frequent communication has an impact on the degree and length of voluntary curtailment by customers. One interesting fact is that over 1,000 citations were issued during the drought of 1999 for illegal outdoor water use. The Company believes that the timely price signal that can be delivered through more frequent meter readings will have the impact of further restricting demand in the event that we ever enter the Water Rationing Phase.

Witness Responsible:

Michael A. Miller

55. In response to Commission Staff's Second Set of Information Requests, Item 31, Kentucky-American states that, "[t]he 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." State whether Kentucky-American stockholders considered increasing their contribution to the fund.

Response:

The Company charges its contribution to the Water for Life Program below the line and thus it is not a part of its requested cost of service in this case, however, the Company does review its contributions to the community annually and will review the funding of this item in relation to the level of assistance requested from the Program, and consider an increase to this Program in relation to the numerous requests the Company receives for funding or increased funding for many other community organizations.

Witness Responsible:

Michael A. Miller

56. In response to Commission Staff's Second Set of Information Requests, Item 26(a), Kentucky-American states that, "[t]he purpose of the low income tariff is to provide assistance to those customers who have the most difficulty in paying monthly utility bills and along with other monthly requirements."

    a. Explain why Kentucky-American has proposed to reduce the service charge and not the water usage portion of the bill.

    b. Explain why the proposed discount is not applied to the water usage portion of the low income customer's bill.

Response:

a. Please see response to KAW_R_PSCDR# 47(e) above.

b. Please see response to KAW_R_PSCDR# 47(e) above.

Witness Responsible:

Linda Bridwell

57. In response to Commission Staff's Second Set of Information Requests, Item 39, Kentucky-American states that, "[f]or the new services contract, all pre-qualified pipeline contractors are invited to bid. Probationary contractors are not invited to bid on the new services contract. 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."

    a. State whether, if only the pre-qualified contractors are allowed to bid and if they are awarded the contract, their performance would not have already been evaluated prior to this process.

    b. State whether, if only the pre-qualified contractors are allowed to bid and if they are awarded the contract, their prices would not have already been considered reasonable.

    c. State whether, if a contract is being granted for a certain cost, is it not reasonable to assume that Kentucky-American knows the "tapping fee" required for that year and should not be required to update its tariff based on this amount yearly.

Response:

a. The contractor performance in general is evaluated prior to the bid process for new service. Further, the contractor actually performing the work is evaluated on his work under the new service contract to determine if Kentucky American wants to negotiate to extend the contract an additional term or re-bid the contract the following year.

b. The contractor prices are considered reasonable in general in order to bid on the new services contract. Further, in making the determination at the end of the term whether to negotiate to extend the contract an additional term or re-bid the contract, the prices for the new services contract are reviewed.

Witness Responsible:

Linda Bridwell

c. No, Kentucky American Water will not know the "tapping fee" based only on the contract for new services for that year. The contract has a set price for short services, a different price for long services, and allowance for additional costs per foot for services beyond 60 feet. Additionally, the contract has a price for open cut services in rock separate from long services that are bored under the road. The number of each of those types of services per year will change the average price per service. Further, the contract has a different price for individual and dual meter settings, so the average service price is reduced the more services that are installed as dual services. Additionally, material costs can vary per service depending on the average length of services. Finally, there are company costs that are applied to all of the services including labor and associated inspection and inventory costs. Those costs per service will vary depending on the number of services per year. Since there has been a significant increase over the last seven years, it may be more reasonable to have a tap fee that automatically changes each year based on a historical two- or three-year average rather than a set tariff amount that is only changed when rates are changed.

Witness Responsible:

Linda Bridwell

58. Kentucky-American states in its response to Item 39 of Commission Staff's Second Set of Information Requests that, "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."

a. Would it be reasonable to use a 2-year average or use a 5-year average for your time frame?

b. Do the costs fluctuate that much that Kentucky-American could not consider a different time frame in its average?

Response:

a. A 2-year average would be a short, but realistic time period and would be reasonable. Based on the seven year history, a 5-year average would not reflect current pricing and would not be reasonable.

b. Kentucky American Water would certainly consider a different time frame in its average if the Commission feels that there is a more appropriate time frame to utilize. Since 1997, the residential service cost, not including the meter, has been:

2003 - $499

2002 - $465

2001 - $432

2000 – not calculated

1999 - $331

1998 - $459

1997 - $381

Part of the difference from 1998 to 1999 was the significant change in the number of services between the two years.

Witness Responsible:

Linda Bridwell

59. In response to Commission Staff's Second Set of Information Requests, Item 43, Kentucky-American states that, "[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."
    a. State whether a separate contract is used for this type of work.
    b. Identify the official who determines if an installation is "particularly difficult."
    c. Define "particularly difficult installation."

Response:

a. No, a separate contract is not executed for this type of work. The current new services contractor offered a per diem price to include labor and equipment for service in Owen County under the terms of the current contract.
b. The Operations Supervisor – Northern Division
c. Long services in excess of 100 feet or that may have significant rock and are located in high traffic areas. This has only been utilized for a handful of services, all other services are installed by Northern Division personnel.

Witness Responsible:

Michael A. Miller

60. Refer to Kentucky-American's Response to the AG's First Request for Information, Item 75 at 5 and Item 121, and Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 15. Explain why, in light of recent salary increases of a much lower rate, Kentucky-American's use of a salary increase rate of 4.75 percent is appropriate and reasonable.

Response:

The 4.75% salary increase rate is a long-term rate, which the actuarial consultant has deemed to be appropriate for pension calculations. Under SFAS 87, the compensation increase rate is a long-term assumption and does not necessarily need to fluctuate from year to year based on the short-term outlook. The compensation increase rate should take into account not only general levels of pay increases but also productivity, seniority, promotion and other factors that ultimately affect the projected level of individual participant's pension payments.

Witness Responsible:

Michael A. Miller

61. State why it is reasonable to include for rate-making purposes the portion of the incentive pay reward attributable to Kentucky-American's financial performance when the benefits of such reward accrue only to Kentucky-American shareholders.

Response:

KAWC does not agree with the statement contained in the question. The annual and long-term incentive plan are structured to incorporate a culture in management to continually strive to seek out efficiencies and cost saving measures whenever possible. It is not true in the regulated environment in which KAWC operates that only the shareholders benefit when strong financial performance is obtained. As the Company continues to operate more productively and efficiently the savings from those efforts enhance shareholder return until other factors (such as capital investment, inflation, etc.) drive the need to increase rates. Once new rates are approved those savings then are flowed directly to the customers. Efficiency and productivity gains, and associated cost savings, promoted by the incentive plans will directly benefit the customers in that they help offset increased costs in other areas of the business and can help prolong the need to raise rates, and once a rate increase is necessary it will be less than what the need to increase rates would have been if the efficiency and productivity gains, and associated cost savings had not been made. The customers are the ultimate beneficiaries of the financial benefits that accrue from the strong financial performance of the Company as are the stockholders on the interim period between rate cases.

The Company has also stated that incentive pay plans are common in most companies and many utility companies. One of the goals of the incentive plans is to provide a competitive overall compensation package in order to attract and retain employees possessing the high

Witness Responsible:

Michael A. Miller

qualifications and technical skills required to manage and operate a major utility. The customers benefit in the form of enhanced service and lower cost when the Company is able to attract, motivate, and retain employees with high qualifications and management skills.

Witness Responsible:

Michael A. Miller

62. Refer to Kentucky-American's Response to the AG's First Request for Information, Item 57. Provide a schedule that details the allocation of the entire cost for each item listed. This schedule shall include the name of each entity receiving an allocation of these costs, the entity's number of customers, total number of customers for all entities, percentage of number of customers for each entity, the amount allocated to each entity, and the total allocated costs.

Response:

Please see the attached schedule KAW_R_PSCDR2#62_attachment_080604.pdf. The amounts included in the Company's filing and the response to AG1-57 are net of amortizations and based on 13-month averaging.

Witness Responsible:

Mike Miller

63. Refer to Kentucky-American's Response to Commission Staff's First Set of Information requests, Item 1, Workpaper 3-7. Provide a detailed summary of the total pension costs of $35,623,816. The breakdown shall show separately the amounts included for service costs, interest, return on plan assets, amortization and gains and losses.

Response:

Service Cost	20,084,540
Interest Cost	36,905,447
Expected Return on Assets	(23,924,127)
Amortization:	
Transition Obligation (asset)	(4,853)
Prior service cost (credit)	318,729
Net Loss (gain)	2,244,080
Pension Cost	35,623,816

Witness Responsible:

Michael A. Miller

64. State whether Kentucky-American has adjusted its shareholders equity for a portion of AWWC's minimum pension liability in excess of its accrued pension costs as reflected in American Water Works Pension Plan: Actuarial Valuation Report (Towers Perrin November 2003) at 8. Explain.

Response:

No. KAWC is contributing its allocated portion of the ERISA contribution to the American Water Works Pension Plan. KAWC has historically been regulated under FAS87 (accrual pension expense) by the Commission. KAWC charges to earnings its pension expense under the accrual method prescribed by FAS87, and the Commission's regulation. The Company is not certain of the meaning of the phrase "adjusted its shareholder equity for a portion of AWWC's minimum pension liability" in the question above, but to the extent the FAS87 expense is charged to income it impacts earnings and dividends, and thus adjusts shareholders equity through its impact on retained earnings. To the extent the cash pension contributions under ERISA are less than or more than the FAS87 expense in any given year that difference is recorded to the balance sheet under pension liabilities.

Witness Responsible:

Michael A. Miller

65. Refer to Kentucky-American's Response to the AG's First Request for Information, Item 94. Provide all correspondence received from each consultant in response to the RFP.

Response:

Other than the proposal submitted by Anderson Consulting (now Accenture), the Company did not retain correspondence with other consultants responding to the RFP. The Anderson Consulting Proposal is attached. Please refer to KAW_R_PSCDR3#65_attachment_080604.pdf.

Witness Responsible:

Linda Bridwell

66. Refer to Kentucky-American's response to Item 105 of the AG's First Request for Information. Identify all office equipment that will be replaced by the items listed. Has the replaced equipment been removed from office furniture and equipment as stated in the forecasted test period? Provide the journal entries used to record the retirements.

Response:

Please refer to KAW_R_PSCDR3#66_attachment_080604.pdf for a listing of all retirements to Office Furniture and Equipment Plant accounts through July 2004 and for journal entries used to record the retirements from August 2003 to July 2004. The Five Months Ended July 2004 on Page 5 of 24 in W/P 1-1 include the previous SCADA software and PC's, and estimated at $84,450.

Actual retirements for the period through July 31, 2004 have totaled $9,900.88 because of retirements that have not been completed. These include the SCADA project system components to be retired, which are still operational while all of the data is being transferred and the new system is being tested, and PC's related to the ORCOM system implementation that are waiting to be cleaned before they are disposed. Details of both are also in the attachment and are expected to be completed in the next couple of months. The previous customer service software that has been replaced by ORCOM is still operational for historical records, but was transferred off the utility plant records of Kentucky American Water in the early 1990's.