

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

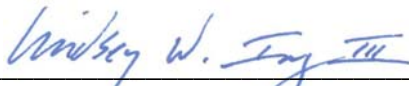
IN THE MATTER OF:)
)
NOTICE OF ADJUSTMENT OF THE RATES OF) **CASE NO. 2004-00103**
KENTUCKY-AMERICAN WATER COMPANY)
EFFECTIVE ON AND AFTER MAY 30, 2004)

NOTICE

Comes Kentucky-American Water Company, by counsel, and for its Report to the Commission required by Ordering Paragraph 13 of the Commission's Order dated February 28, 2005, and states that it has prepared a description of (1) a process for the handling of revenue generation during implementation of the EPT and (2) a process for exemptions or variances from water base usage restrictions in the rationing phase of the EPT and each are attached.

Kentucky-American Water Company invites comments from the parties in response to these attachments.

STOLL, KEENON & PARK, LLP
300 West Vine Street, Suite 2100
Lexington, Kentucky 40507-1801
Telephone: (859) 231-3000

BY: 
Lindsey W. Ingram, Jr.
Lindsey W. Ingram III

ATTORNEYS FOR
KENTUCKY AMERICAN WATER

CERTIFICATION

This is to certify that a true and accurate copy of the foregoing has been electronically transmitted to the Public Service Commission on August 30, 2005; that the Public Service Commission and other parties participating by electronic means have been notified of such electronic transmission; that, on August 31, 2005, the original and one (1) copy in paper medium will be hand-delivered to the Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601; and that on August 31, 2005, one (1) copy in paper medium will be served upon the following via U.S. Mail:

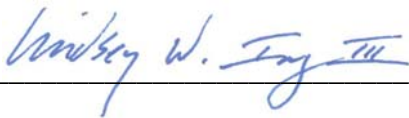
Gregory D. Stumbo, Esq.
David Edward Spenard, Esq.
Office of the Attorney General
1024 Capital Center Drive, Suite 200
Frankfort, Kentucky 40601
david.spenard@ag.ky.gov
dennis.howard@ag.ky.gov

Leslye M. Bowman, Esq.
David J. Barberie, Esq.
Lexington-Fayette Urban County Government
Department of Law
200 East Main Street
Lexington, Kentucky 40507
lbowman@lfucg.com
dbarberi@lfucg.com

Joe F. Childers, Esq.
201 W. Short Street, Suite 310
Lexington, Kentucky 40507
childerslawbr@yahoo.com
jparker@commaction.org

Foster Ockerman, Jr., Esq.
Martin, Ockerman & Brabant LLP
200 North Upper Street
Lexington, Kentucky 40507
ockerman@kycounsel.com

STOLL, KEENON & PARK, LLP

By 

ATTORNEYS FOR
KENTUCKY AMERICAN WATER

Kentucky American Water
Proposed Handling of Over\Under Revenue Generation
During Implementation of the Emergency Pricing Tariff

On May 16, 2005 representatives of the LFUCG, the AG's office, the Commission Staff, Bluegrass FLOW, and the Company met to discuss the Emergency Pricing Tariff ("EPT") of KAW. Two primary areas of concern developed from that meeting: i) how and who would be responsible for establishing a review committee to determine exceptions to the EPT for such items as medical exemptions, and to address customer challenges to the EPT, and ii) how would any over or under recovery of revenue related to implementing the EPT as part of the KAW Drought Emergency Plan be handled. The following is the Company's recommendation to address any over\under recovery of revenue during the implementation of the EPT.

The LFUCG, the AG, Bluegrass FLOW, and the Commission Staff expressed concern that the implementation of the EPT during a drought situation would provide the Company a windfall of revenue. The Company, on the other hand, was concerned that the significant increase in price during implementation of the EPT would curtail usage to the safe yield level and little, if any, additional revenue from the EPT would be realized. The Company believes it would in fact see a significant decline in revenue and severe erosion of its earnings during a drought event of the magnitude to necessitate use of the EPT. In addition, it was recognized by all parties that KAW would experience a significant increase in expenses for public notification, additional meter reading, programming and monitoring of individual customer usage, and other customer related activities. Generally the parties agreed that a true-up mechanism may provide a level of comfort to all parties that KAW would not over earn its authorized ROE during such a drought period nor should the Company incur significant financial harm.

The Company proposes that a true-up surcharge mechanism should be made a part of the Commission's approval of the EPT. The following is an outline of how the net revenue gain\loss and expenses would be tracked during the year in which a drought occurs and the EPT is implemented.

1. During a drought year, there would likely be increased usage and revenue in the early periods of the drought. If the drought conditions persisted then mandatory restrictions would be imposed when sources of supply are being depleted or compromised and those restrictions would reduce usage and revenue. Only if the drought conditions persisted and mandatory restrictions did not lower usage to acceptable levels would the EPT be implemented.

2. The Company proposes that during any annual period where the EPT was necessarily implemented, it would make a comparison of the usage per customer for the entire year to that level approved in its last general rate case to determine the amount of over\under recovery of revenue during the drought year. Any additional revenue collected from the EPT would be netted against the regular tariff over\under recovery to determine the net over\under recovery of revenue.

3. In any year in which the drought management plan was implemented, the Company would establish work orders to capture and track only those incremental increases in expenses associated with the drought situation.

4. The Company would then prepare a calculation taking into account the over/under recovery of revenue, additional incremental expenses, net of the appropriate income taxes, and backed by the appropriate accounting records and over\under recovery of revenue schedules, to support a surcharge mechanism to either refund any over recovery or to collect any under recovery during the year in which the EPT was implemented.

5. The Company would make a filing with the Commission supporting the refund or under recovery surcharge. Any party wishing to would have the right to review the surcharge calculation and supporting documents and make appropriate comments.

6. The Commission would act on the surcharge request within a reasonable time. Upon final order of the Commission, the Company would either refund or collect the surcharge through a tariff over the subsequent twelve month period at which time the surcharge tariff would expire.

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Proposed Exemptions or Variances from Water Base Usage Restrictions in the Rationing Phase

The May 16, 2005 meeting also discussed concerns regarding the methodology and review process of decisions to exempt or vary the base usage requirements in the Rationing Phase. There was discussion on the make-up of the review panel and the appeals process. For example, the Office of the Attorney General did not want to participate on the panel, but the LFUCG wanted to consider whether it might be a voting member or an ad hoc member. The following is a proposal for your review.

Exemptions or variances from water base usage restrictions may be available under any of the following circumstances:

1. Where compliance with the base usage restrictions under this Phase would cause serious health issues or threaten the life of the customer or persons served by or living with that customer;
2. Where the customer can show that all reasonable efforts have already been used to restrict water usage to a volume at or below the base usage restrictions in this Phase and that compliance with the restrictions will result in permanent and significant property or financial loss which is substantially more severe than the sacrifices borne by other customers of the same of similar classification; or
3. Where the customer can show an unexpected change in circumstances that has or will result in water usage at a volume greater than the base usage restrictions in this Phase and where the customer can show that all reasonable efforts have already been used to restrict water usage to a volume at or below the base usage restrictions in this Phase.

Proposed Procedure for Evaluating, Approving and Denying Exemptions or Variances

1. At the institution of the Water Shortage Full Alert Phase, the Company will begin a review of customer accounts to determine whether any exemptions or variances from the base usage restrictions should be extended to particular customer accounts based upon the Company's knowledge of those customers. In making such a determination, the Company may use the services of health care professionals or other persons to advise it in making its determination. Notice of the Company's determination regarding an exemption or variance shall be provided in writing to the customer affected, which notice shall include the terms and conditions of the exemption or variance, including any conditions as to time, volume, duration, circumstances or otherwise, and shall explain to the customer the procedure for any review of any such decision.

2. At the institution of the Water Emergency Phase, the Company shall begin communication with its customers in a manner reasonably designed to reach its customers and inform them of: (a) the base usage restriction for each customer in the Rationing Phase, (b) a notice that any customer may request, in writing, an exemption or variance from such base usage restriction, (c) information on how, when and where the review must be made and (d) the process for seeking a review of the denial of exemption or variance from the base usage restrictions in the Rationing Phase.

3. At the institution of the rationing Phase, a panel of three persons representing the Company, the Lexington-Fayette Urban County Government and the Community Action Council shall be convened to review all applications for exemptions and variances from the base usage restrictions in the Emergency Phase. Decisions by the panel may be by consensus or by majority vote, shall be recorded in writing with reasons for the approval or denial and shall be

timely communicated to the applicant with the reasons therefore. Before issuing a denial of an application based on health issues, the panel shall consult with a health care professional before making such a decision. The communication of a denial shall be in writing and accompanied by a description of the rights of the applicant to file a complaint to the Kentucky Public Service Commission and a statement that the applicant should consult his or her legal professional for advice.

4. The panel shall meet in Lexington, Kentucky as often as necessary to process all applications in a timely manner. Any applicant shall be entitled to address the panel in person and may be accompanied by a representative of their choosing.

5. The panel shall serve until the conditions are such that the Company is no longer in its Rationing or Emergency phase.