

REGULATORY ASSET AUTHORIZATION

Kentucky-American Water Company

Security Costs
(Expense to be deferred)

Description of expense to be deferred:

The Company has deferred its ongoing Operations & Maintenance costs associated with increased security costs put into effect after the extraordinary events of September 11, 2001 for future rate recovery. The current deferral amount is \$297,596.

Plan to address recovery in rates:

The Company has filed a request with the Public Service Commission for an emergency surcharge to recover this cost or in the absence of that surcharge for permission to defer these costs as a regulatory asset. The Company believes the rate recovery of these costs to be probable.

Submitted By:

M. Hill
Vice President & Treasurer

1-31-02
Date

Reviewed By:

[Signature]

4/4/02
Date

Updated Information:

REGULATORY ASSET AUTHORIZATION

Kentucky-American Water Company

Business Services Projects Costs
(Expense to be deferred)

Description of expense to be deferred:

One-time projects costs with the transition to the Shared Services and the National Call Center. These costs are being deferred for future rate recovery because they are unusual, one-time costs that are expected to result in significant savings in operating costs. The Company has deferred \$1,360,000 as of December 31, 2001, and expects to defer an additional \$242,000 in 2002.

Plan to address recovery in rates:

See attached.

Submitted By:

M. Miller
Vice President & Treasurer

1-31-02
Date

Reviewed By:

[Signature]

4/4/02
Date

Updated Information:

Deferred Business Services Project Expenses

Company: Kentucky-American

Deferred Business Services Project expenses at 12/31/2002: \$1,454,542.33 (see attached)

State Commission accounting requirement(s) for deferred Business Services Project expenses and status of any requests for permission to defer these costs (attach related correspondence): Required to seek approval to defer costs. The Company filed for deferral in March 2002. See attached letter.

Describe any other meetings and/or correspondence with the State Commission or Staff regarding Deferred Business Services Project expenses: The Company met with Staff to describe the project, estimated costs and address questions.

Effective date of the last rate order received: March 2001

Describe any rate recovery currently in place for these deferred costs (which aspects of project were covered, annual amount of rate recovery, future earnings tests, etc.): The Company is amortizing the Shared Services deferral at the level of projected savings and will do the same for the Call Center after the move projected for third quarter 2003. The Company will request the unamortized deferral to be included in the rate case to be filed in March 2004.

Anticipated filing date(s) for rate recovery of the deferred Business Services Project expenses: March 2004

Anticipated effective date(s) of rate order(s) addressing rate recovery of the deferred Business Services Project expenses: October 2004

Describe any agreements associated with the RWE/Thames acquisition that would limit or delay recovery of the deferred Business Services Project expenses: The Settlement Agreement in the RWE/Thames filing included a rate filing stay-out until March 2004.

Is it probable (defined as likely to occur) that the deferred Business Services Project expenses will be recovered through rates? Yes or No

Deferred Security Costs

Company: Kentucky-American

Deferred Security costs at 12/31/2002: \$1,703,115.78 (see attached)

State Commission accounting requirement(s) for deferred Security costs and status of any requests for permission to defer these costs (attach related correspondence): Approval of deferral required.

Describe the status and outlook for any generic rate proceedings regarding deferred Security costs (attach related documents): None

Describe any other meetings and/or correspondence with the State Commission or Staff regarding deferred Security costs (attach related correspondence): The Company filed a surcharge tariff in December 2002. This tariff was withdrawn as part of the RWE settlement. The Commission, in its Order (attached), indicated the Company would be permitted to seek rate recovery in its next rate case that will be filed in March 2004.

Effective date of the last rate order received: None

Describe any rate recovery currently in place for deferred Security costs (annual amount of rate recovery, future earning tests, etc.): None (see attached RWE order)

Anticipated filing date(s) for rate recovery of the deferred Security costs: March 2004

Anticipated effective date(s) of rate order(s) addressing rate recovery of the deferred Security costs: October 2004.

Describe any agreements associated with the RWE/Thames acquisition that would limit or delay recovery of the deferred Security costs: With drew surcharge tariff as part of settlement agreement.

Is it probable (defined as likely to occur) that the deferred Security costs will be recovered through rates? Yes or No

Southeast Region
Year End Audit of Deferred Costs

Customer Service 183280	12/31/2002	Amtz per Month
Kentucky	599,852.66	0.00 Start 10/03 at projected savings level
Maryland	30,585.55	0.00
Tennessee	845,750.04	0.00 Start 7/03
Virginia & Eastern	180,530.59	3,046.50 Approved in 2002 rate case to start 4/03
West Virginia	<u>1,540,456.14</u>	<u>12,500.00</u> Started Jan 02
	3,197,174.98	15,546.50

Shared Services 183281	12/31/2002	Amtz per Month
Kentucky	854,689.67	13,417.00 Started 2/02 at projected savings level
Maryland	3,928.28	3,667.00 Started Jan 02
Tennessee	362,263.61	0.00 Start 7/03
Virginia	462,449.49	3,877.94 Started Dec 02
Virginia-Eastern	16,312.37	136.77 Started Dec 02
West Virginia	<u>1,775,200.19</u>	<u>0.00</u> Start 1/1/04
	3,474,843.61	21,098.71

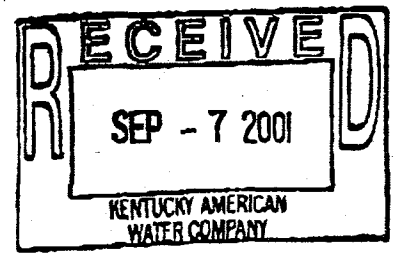
Security 186492	12/31/2002	Amtz per Month
Kentucky	1,703,115.18	0.00 Start 10/04
Maryland	179.15	0.00
Tennessee	198,367.14	0.00 Start 7/03
Virginia	247,047.50	7,058.50 Started Dec 02 for 36 months
Virginia-Eastern	0.00	0.00
West Virginia	<u>2,732,442.09</u>	<u>0.00</u> Start 1/04
	4,881,151.06	7,058.50

Virginia balance @ 9/30/02	343,020.02
JE to expense in December	<u>(88,914.02)</u>
Bring def bal to SSC approval	254,106.00

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

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LINDSEY W. INGRAM, JR.
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September 6, 2001

Mr. Tom Dorman
Public Service Commission
211 Sower Blvd.
Frankfort, Kentucky 40601

RE: Kentucky-American Water Company – Deferrals

Dear Tom:

By Order dated November 27, 2000, in Case No. 2000-120, the Commission ordered Kentucky-American to apply for the approval of the accruing of expenses as regulatory assets. The purpose of this letter is to request Commission approval of the establishment of regulatory assets to accrue the following expenses:

1. Acquisitions. Kentucky-American incurs costs in acquiring and attempting to acquire water utilities. Typically the costs would include engineering, financial, legal, appraising, accountants, and efforts to comply with contractual, regulatory and permitting requirements. To date Kentucky-American has incurred costs relative to five potential acquisitions as follows:

<u>Entity</u>	<u>Accruals</u>
Municipality A	\$54,954.44
Municipality B	\$12,255.01
Municipality C	\$15,664.79
Water Company A	\$45,341.92
Water Association A	\$ 3,751.75

If the Commission is interested in the specific identification of the entities, Kentucky-American will be glad to provide that information subject to confidential treatment by the Commission.

Mr. Tom Dorman
September 6, 2001
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2. Preliminary Service and Design. Kentucky-American incurs costs for water main extensions and installations such as engineering, legal, surveying, geotechnical, environmental, appraisal and land acquisition costs. At the present time Kentucky-American requests specific approval for the deferral of \$73,453.61 incurred to date for the North Broadway project and \$80,000 projected to be incurred for the Leestown Road project.

The North Broadway project involves the replacement of a 6-inch cast iron main extending from Short Street to Loudon Avenue which was installed in 1885. Initially Kentucky-American intended to install an 8-inch main but the project has been temporarily deferred pending a study of future water demands in the area and associated fire flow requirements. The Leestown Road extension is scheduled for construction in 2002 and involves the installation of a 16-inch main from Sandersville Road to the end of the urban services area. The size and length of this facility is currently under review pending the resolution of any regional source of supply issues.

3. Tank Painting. Consistent with the treatment afforded Kentucky-American in rate orders, Kentucky-American projects a cost of \$305,000 to paint the Tates Creek elevated storage tank.

4. Sludge Removal. Again, consistent with prior orders Kentucky-American seeks to defer \$200,000 as the project costs for the removal of sludge from the Kentucky River treatment plant.

5. Customer Service Consolidation. American Water Works has established a Call Center in Alton, Illinois, and Kentucky-American plans to utilize those facilities in the third quarter of 2002. Service to Kentucky-American's customers will be greatly improved. All customer contacts, billing inquiries, service issues, and field service emergencies can be handled by the Alton Call Center by telephone on a 24-hour per day, 7-day per week basis. At the present time telephone customer service is provided only during normal working hours. Kentucky-American anticipates transition costs of approximately \$525,000. The deferred expenses will be reduced by savings in operating costs in the future as they are realized. Any unamortized deferred expense can be considered in Kentucky-American's next rate case if savings have not eliminated the deferral at that time.

6. Financial Service Consolidation. American Water Works is in the process of establishing a shared Service Center in New Jersey to provide accounting, finance, human resources and rate assistance and analysis in the first quarter of 2002. Kentucky-American anticipates a transition cost of \$918,000. As with the Call Center, Kentucky-American anticipates the deferred expense will be reduced by savings in operating costs over time and any

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unamortized deferred expense will be considered in Kentucky-American's next rate case if the then accumulated savings have not eliminated the deferred costs at that time.

As usual, we will be glad to supply any additional information that the Commission or staff may require.

With best regards, I am

Very truly yours,

STOLL, KEENON & PARK, LLP

By 
Lindsey Ingram, Jr.

/s/

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Mr. Tom Dorman
September 6, 2001
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bcc: Roy W. Mundy II
Nick O. Rowe
Herbert A. Miller, Jr., Esq.
Michael A. Miller



Kentucky-American Water Company

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Herbert A. Miller, Jr.
Vice President and
Corporate Counsel
(859) 268-6339

July 2, 2002

Hon. Tom Dorman
Public Service Commission
211 Sower Blvd.
Frankfort, KY 40601

Re: Kentucky-American Water Company:
Deferrals

Dear Mr. Dorman:

By Order dated November 27, 2000, in Case No. 2000-120, the Commission ordered Kentucky-American Water Company (the "Company") to apply for the accruing of expenses as regulatory assets. On September 26, 2001, the Company filed a request with the Commission for such treatment on other matters unrelated to this request.

Following the events of September 11, 2001, and due to heightened security needs generally for water supply systems, on November 28, 2001, in Case No. 2001-00440, the Company sought to amend its filed rate schedules to permit the assessment of an Asset Protection Charge rather than seek treatment as a regulatory asset. This application for the rate surcharge recovery of security costs did not reach a conclusion on its merits, before the Commission, in Case 2002- 00018, included a condition that stated:

"KAWC will, within 10 days of the date of this Order, withdraw its proposed Asset Protection Charge Tariff that is currently the subject of review in Case No. 2001-00440 and will not for 5 years from the date of this Order apply to the Commission for recovery of costs associated with the protection of water utility assets except through adjustments in its general rates for water service."

The Company accepted this condition and has complied with the terms of the Order.

Consequently, through the request contained in this letter, the Company respectfully requests that the Commission approve the establishment of regulatory assets to accrue the expenses associated with security and the protection of the Company's assets, personnel and customers.

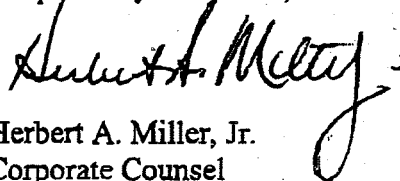
Hon. Tom Dorman
July 2, 2002
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Utility expenses associated with security measures, and cost recovery thereof, have been recognized by the NARUC Board of Directors as special needs that may not be either revenue producing or are items that are likely to produce efficiencies by reducing expenses over time. Nevertheless, NARUC has encouraged water utilities "to take all necessary and prudent precautionary steps to secure facilities." NARUC Resolution of the Board of Directors dated November 13, 2001 (copy attached).

Kentucky-American Water Company responded to the urgency of the threat after September 11, 2001 and continues to respond today. The Company is in frequent communication with law enforcement agencies on federal, state and local levels to monitor, measure and respond to various levels of threats.

As a result, the Company has incurred, and continues to incur, significant expenses associated with the protection of its assets. Kentucky-American Water Company hereby requests that it be permitted to treat these expenditures as regulatory assets and defer the expenses until its next general rate case.

Respectfully submitted,



Herbert A. Miller, Jr.
Corporate Counsel

Attachment

Deferred Business Services Project Expenses

Company: Kentucky-American

Deferred Business Services Project Expenses at 12/31/2001:

\$1,360,000

Anticipated Business Services Project Expenses to be incurred after 12/31/2001:

\$242,000

Anticipated Payback Period:

Call Center – 3.72 years

Shared Services – 5.70 years

State Commission Accounting Requirement(s) for Deferred Business Services Project Expenses: Regulatory Asset requires PSC approval.

Recent State Commission or Staff Comments Regarding Deferred Business Services Project Expenses: The petition requesting regulatory asset status was filed in October 2001. Meetings with the Staff have been held. No strong objections have been noted.

Will the Deferred Business Services Project Expenses be Recoverable Through Rates? Yes or No Probable.

Anticipated Filing Date for the Recovery of the Deferred Business Services Project Expenses: The current Strategic Plan calls for a rate case in 2003. The Company will request rate recovery in that case and fully expects to recover the unamortized transition cost in that case.

Date of the Latest Rate Order: December 2000.

Anticipated Effective Date of Rate Order Addressing Rate Recovery of the Deferred Business Services Project Expenses:
December 2003.

**SHARED SERVE CENTER AND CUSTOMER SERVICE CENTER
SAVINGS AND AMORTIZATIONS**

TENNESSEE		2002	2003	2004	2005	2006	2007	2008	TOTAL
SSC	SAVINGS	(225)	(225)	(225)	(225)	(225)	(225)	(225)	
	AMORT	225	225	196	0	0	0	0	646
	NET	0	0	(29)	(225)	(225)	(225)	(225)	
CCC	SAVINGS	0	(208)	(208)	(208)	(208)	(208)	(208)	
	AMORT	0	208	208	66	0	0	0	482
	NET	0	0	0	(142)	(208)	(208)	(208)	
TOTAL	0	0	(29)	(367)	(433)	(433)	(433)	(433)	
WEST VIRGINIA		2002	2003	2004	2005	2006	2007	2008	
SSC	SAVINGS	(195)	(195)	(195)	(195)	(195)	(195)	(195)	
	AMORT	0	147	147	147	147	147	147	882
	NET	(195)	(48)	(48)	(48)	(48)	(48)	(48)	
CCC	SAVINGS	(278)	(278)	(278)	(278)	(278)	(278)	(278)	
	AMORT	81	150	150	150	150	150	150	981
	NET	(197)	(128)	(128)	(128)	(128)	(128)	(128)	
TOTAL	(392)	(176)	(176)	(176)	(176)	(176)	(176)	(176)	
VIRGINIA		2002	2003	2004	2005	2006	2007	2008	
SSC	SAVINGS	(178)	(178)	(178)	(178)	(178)	(278)	(278)	
	AMORT	49	98	98	98	98	49	0	490
	NET	(129)	(80)	(80)	(80)	(80)	(229)	(278)	
CCC	SAVINGS		7	7	7	7	7	7	
	AMORT		73	73	73	73	73	0	365
	NET	0	80	80	80	80	80	7	
TOTAL	(129)	0	0	0	0	0	(149)	(271)	
Kentucky		2002	2003	2004	2005	2006	2007	2008	
SSC	SAVINGS	(161)	(161)	(161)	(161)	(161)	(161)	(161)	
	AMORT	161	161	161	161	161	113	0	918

	NET	0	0	0	0	0	(48)	(161)	
CCC	SAVINGS		(184)	(184)	(184)	(184)	(184)	(184)	
	AMORT		184	184	184	133	0	0	685
	NET	0	0	0	0	(51)	(184)	(184)	
	TOTAL	0	0	0	0	(51)	(232)	(345)	
<u>Maryland</u>									
SSC	SAVINGS	(44)	(44)	(44)	(44)	(44)	(44)	(44)	
	AMORT	44	0	0	0	0	0	0	44
	NET	0	(44)	(44)	(44)	(44)	(44)	(44)	
CCC	SAVINGS		(13)	(13)	(13)	(13)	(13)	(13)	
	AMORT		13	13	7	0	0	0	33
	NET	0	0	0	(6)	(13)	(13)	(13)	
	TOTAL	0	(44)	(44)	(50)	(57)	(57)	(57)	

Note:

The WVAWC and VAWC amortizations will be requested in the 2002 and 2003 rate cases currently included in Strategic Business Plan.

The WV Commission allowed a 10 year amortization of the call center transition costs and the Company is ex treatment for the shared services transition costs.