

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2004-00103
ATTORNEY GENERAL'S THIRD REQUEST FOR INFORMATION
ITEMS 1-27

Witness Responsible:

James H. Vander Weide

1. Reference: Rebuttal Testimony of Dr. Vander Weide, page 25, lines 1-10. Please provide copies of all studies that support Dr. Vander Weide's assertion that a higher net plant to revenues ratio for a regulated public utility is related to the business and financial risks.

Response:

The request for *all* studies is overly broad in that it would be impossible to provide all studies that support Dr. Vander Weide's assertion. As explained on page 25, lines 1 – 10, the ratio of net plant to revenues is a measure of fixed costs in relation to revenues. A company with a higher percentage of fixed costs in relation to revenues is considered by the financial community to have high operating leverage. It is generally recognized in financial textbooks that, other things equal, a firm with a higher percentage of fixed costs in relation to revenue, that is, a firm with higher operating leverage, has greater business risk than a firm with lower operating leverage. See, for example, Brealey and Myers, *Principles of Corporate Finance*, 6th edition, pp. 240 – 241. A company with a higher ratio of fixed costs to revenues has greater risk, other things equal, because such a firm has greater variability in operating income than companies with a lower percentage of fixed costs in relation to revenues.

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Witness Responsible:

James H. Vander Weide

2. Reference: Rebuttal Testimony of Dr. Vander Weide, page 26, lines 14-21. Please provide copies of any refereed publications in which Dr. Vander Weide has published his findings found in Appendix 1 of his original testimony that his quarterly DCF model is appropriate in estimating the cost of equity.

Response:

Appendix 1 of Dr. Vander Weide's direct testimony is not intended to be a research paper suitable for publication in a refereed journal. Rather, it is intended to be a simple, logical explanation of the derivation of the quarterly DCF model from the assumption that dividends are paid quarterly. The logic of the quarterly DCF model stands on its own, whether or not it has been published in a journal.

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Witness Responsible:

James H. Vander Weide

3. Reference: Rebuttal Testimony of Dr. Vander Weide, page 29, lines 3-10 and Attachment A. With respect to Attachment A, please provide the following:
- a. In what State Street Global Advisers or other publications has the study found in Appendix A been published? Please provide copies of all such publications.
 - b. Please indicate any participation by Dr. Vander Weide in the preparation of the study.
 - c. Please indicate any association between Dr. Vander Weide and State Street Global Advisers and/or the authors of the study – Anita Xu and Ami Teruya.
 - d. Please provide all data used in the study in electronic format (Microsoft Excel readable) on a CD ROM. The individual data items should be provided in a format such that all regressions can be duplicated.

Response:

- a. Since the study described in Attachment A has only recently been completed, Dr. Vander Weide would be surprised if State Street Global Advisers has had time to publish these results. Dr. Vander Weide has not been informed whether State Street Global Advisers intends to publish this study, or, instead, to use it for internal purposes.
- b. Dr. Vander Weide took part in a few telephone conversations in which he was asked questions about his research methodology and findings in his study published in *The Journal of Portfolio Management*. Dr. Vander Weide did not initiate the State Street study, did not perform the regression studies, and was not paid as a consultant.
- c. Dr. Vander Weide does not have any association with State Street Global Advisors or the authors of the study.

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- d. Since Dr. Vander Weide did not perform the study himself, he does not have the data that went into the study. The attached file KAW_R_AGKYDR3#3_attachment_110304.pdf contains all the information regarding the regression studies, not already included in Attachment A, which was supplied to Dr. Vander Weide by State Street Global Advisors.

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Witness Responsible:

James H. Vander Weide

4. Reference: Rebuttal Testimony of Dr. Vander Weide, page 30, lines 7-11. Provide the data employed and show all statistical tests that were performed to conclude that the difference between historic and projected growth rates in explaining stock prices is statistically significant.

Response:

As reported in the Vander Weide/Carleton paper, the t statistics associated with coefficients for the analysts' growth rates are approximately 1 ½ to 4 times larger in absolute value than the t statistics associated with the coefficients for the historical growth rates. In addition, the r-square and F ratios for the equations with the analysts' growth forecasts are all higher than the r-square and F ratios for the equations with the historical growth rates. Furthermore, this relationship holds in each of the time periods studied, and is consistent with the results of other studies in the literature, including the studies by Cragg and Malkiel and the recently completed studies by State Street Global Advisors. Given the overwhelming superiority of the equations containing the analysts' forecasts compared to the equations containing the historical growth forecasts, the significance of the results should be obvious.

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Witness Responsible:

James H. Vander Weide

5. Reference: Rebuttal Testimony of Dr. Vander Weide, page 35, lines 16-23. Please provide copies of all studies that support Dr. Vander Weide's assertion that 'survivorship bias' is not a major issue in assessing returns in U. S. capital markets.

Response:

The request for "all studies" is overly broad because it would not be possible to provide all studies that support for Dr. Vander Weide's assertion that survivorship bias is not a major issue in assessing returns in U.S. capital markets. In addition, Dr. Vander Weide provided his reasons for asserting that survivorship bias is not a major issue in assessing returns in U.S. capital markets in his testimony at page 35, line 19, to page 36, line 20. The quote from Ibbotson Associates on page 36, lines 16 - 20, indicates that Ibbotson Associates also supports Dr. Vander Weide's opinion.

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Witness Responsible:

Michael A. Miller

6. Is there an error in the update to Schedule B-1, page 1? Specifically, should the depreciation reserve be subtracted from utility plant-in-service? If so, please provide an updated schedule.

Response:

Yes. See the attached update to Schedule B-1. For the electronic version, please refer to KAW_R_AGKYDR3#6_attachment_110304.pdf.

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Witness Responsible:

Coleman Bush/Sheila Valentine

7. Please provide a narrative describing all adjustments made to the Company's forecast period salary and wage claim in its updated filing and include all workpapers.

Response:

There should be no adjustments made to the Company's forecast period salary and wage claim. We adjusted the base period numbers to actual. Account 676400 on page 6 of 19 did not include a balance in the original filing. In the update of the base period, a balance of \$87,450 was included which did not zero out in the adjustment column (Adj -D-4 Sch D-2.3). This account should have a zero balance for the forecast. See the reconciliation below:

Original filing labor balance	\$5,344,642
Base period update labor balance	5,431,113
Variance	86,471
Balance from account 676400 which should zero out in adjustment column	(87,450)
Account 672100 should be line 25 included in labor line in original filing	979

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Witness Responsible:

Sheila Valentine

8. Please provide a narrative describing all adjustments made to the Company's forecast period fuel and power claim in its updated filing and include all workpapers.

Response:

There should be no adjustments made to the Company's forecast period fuel and power claim in the updated filing. Account 601100 on page 3 of 18 did not include a balance in the original filing. In the update of the base period, a balance of \$48,259 was included which did not zero out in the adjustment column (Adj D-5 Sch D-2.3). This account should have a zero balance for the forecast. See the reconciliation below:

Original filing fuel and power balance	\$1,922,641
Base period update fuel and power balance	1,970,900
Variance	48,259
Balance from account 601100 which should zero out in adjustments column	(48,259)

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Witness Responsible:

Michael A. Miller

9. Please provide an update to the response to PSC-2-115 consistent with the Company's updated rate base claim.

Response:

The Company filed a corrected Exhibit 37, Schedule B on August 24, 2004. The revised Schedule B reflects all known changes to the forecasted test-year filing. Please refer to the revised Schedule B for response to this question. There were no changes to the forecasted test-year rate base in the filing of September 15, 2004, which only updated the base year filing to reflect actual results for the 12 months ended July, 2004.

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Witness Responsible:

Coleman D. Bush

10. Please provide updates to PSC-2-57 and PSC-2-52 consistent with the Company's updated expense claim.

Response:

See response to Attorney General's Third Request for Information Item 7. The company did not intend to make any adjustments to the Company's forecast. There should not be any adjustment to labor or incentive.

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Witness Responsible:

Michael A. Miller

11. Please provide the current number of vacant employee positions.

Response:

The following positions are vacant. The listing also includes the current status of filling the positions.

- Communications Specialist – replaces former crew leader position - interviews have been conducted and in the final stages of hiring.
- Field Service Records Clerk – replaces recent resignation of T. Farrow – currently using temp. employee and will fill position permanently.
- Crew Leader – replaces retiree T. Mundy – currently using temp. employee and will fill position.
- Operations Supervisor – replaces retiree D. Owens – in process of filling position permanently.
- 2 Meter Readers – currently using temp. employees and will fill permanently.
- 2 Utility Workers – currently using temp. employees and will fill permanently.
- Operations Engineer – have advertised and interviewed for position. Currently re-advertising to locate acceptable replacement.
- Operations Clerk – replaces recent retiree J. Rhorer – currently using temp. employee and advertising for replacement.
- Maintenance Tech II – currently advertising for permanent replacement.
- Operations Superintendent – replaces recent retiree D. Ary – currently advertising to permanently fill position.
- Operations Supervisor – replaces recent retiree H. Garrison – using temp. employee and advertising to permanently fill position.
- Treatment Plant Operator – replaces recent resignation of B. Horrocks – replacement position advertised and interviews are being conducted.

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Witness Responsible:

Linda Bridwell

12. Reference: Rebuttal Testimony of Linda Bridwell, page 2. Given the history of solids removal from Lake Ellerslie, what documentation can the Company provide to support its contention that solids removal will be conducted on annual basis, as discussed on page 2 of Ms. Bridwell's Rebuttal Testimony?

Response:

Annual solids removal at Richmond Road Station is not based only on solids removal from Lake Ellerslie. It is critical in order to allow the plant to operate potentially at 30 mgd during peak summer demands if needed until a resolution of the treatment plant capacity deficit is in place. Please refer to the response to Item 7 of the Public Service Commission's Fourth Set of Information Requests.

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Witness Responsible:

Coleman D. Bush

13. Reference: Rebuttal Testimony of Coleman Bush, page 2, line 33. Regarding Mr. Bush's contention on page 2, line 33 of his Rebuttal Testimony that an acquisition does not have to result in immediate benefits in order to receive rate recognition, how long after the acquisition does Mr. Bush believe benefits can occur in order to justify inclusion of an acquisition adjustment?

Response:

In the case of Tri-Village and Elk Lake, I believe that many benefits have occurred immediately in significantly improved operations. In my rebuttal testimony, I did not have a specific time frame in mind over which benefits must occur in order to justify inclusion of an acquisition adjustment.

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Witness Responsible:

Coleman D. Bush

14. Reference: Rebuttal Testimony of Coleman Bush, page 4. Regarding page 4 of Mr. Bush's Rebuttal Testimony, please provide the total overtime hours incurred by the Company in each of the past five years.

Response:

2003 – 19,532.75

2002 – 18,104.5

2001 – 18,922.5

2000 – 16,170

1999 – 16,985.5

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Witness Responsible:

Michael A. Miller

15. Reference: Rebuttal Testimony of Michael A. Miller, page 17, lines 21-28. Please provide the amount of debt used to finance the Tri-Village system that was outstanding at the time of the acquisition of the system by KAWC.

Response:

See below:

Tri-Village Water District
Rural Development Loan Payoffs
as of August 2, 2001

Loan Number	Principal Amount	Interest Amount	Total Payoff	Days Interest	Last Payment
02	50,000.00	200.35	50,200.35	36.5636	28-Jun
04	295,000.00	1,232.53	296,232.53	30.4999	2-Jul
05	73,500.00	307.08	73,807.08	30.4991	2-Jul
06	233,000.00	922.19	233,922.19	32.1030	1-Jul
08	797,500.00	3,248.75	800,748.75	30.5003	2-Jul
10	229,700.00	957.02	230,657.02	32.0154	1-Jul
Total	1,678,700.00	6,867.92	1,685,567.92		

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Witness Responsible:

Michael A. Miller

16. Reference: Rebuttal Testimony of Michael A. Miller. Please describe, with specificity, the criteria used to determine the amount of the LIP in each of the past three years, as discussed on page 38 of Mr. Miller's Rebuttal Testimony.

Response:

The Long-Term Incentive Plan is attached to the response to KAW_R_AGKYDR1#123. The payments under the LIP for 2002 and 2003, 2004 were administered under the criteria described in that response.

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Witness Responsible:

James Salser

17. Reference: Rebuttal Testimony of James Salser, page 2. Please provide all supporting calculations, documentation, and workpapers for the Service Company expense lag of (1.34) days.

Response:

The (1.34) refers to the West Virginia American lag days for Service Company. In response to the Attorney General's second data request item 29, the Company calculated the Service Company on Kentucky American's billings to be .40. Please refer to the working papers in response to that data request. Attached are the billings and payments made by Kentucky American Water to the Service Company. For the electronic version see [KAW_R_AGKYDR3#17_attachment_110304.pdf](#).

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Witness Responsible:

James I. Warren

18. Reference: Rebuttal Testimony of James Warren. Please provide a list of all testimonies filed with state regulatory commissions by Mr. Warren and provide the date that each such testimony was filed.

Response:

See attached.

For electronic version, refer to [KAW_R_AGKYDR3#18_attachment_110304.pdf](#).

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Witness Responsible:

James I. Warren

19. Reference: Rebuttal Testimony of James Warren. Please provide the three most recent testimonies filed by Mr. Warren that addressed consolidated income tax adjustments.

Response:

See attached.

For electronic version, refer to [KAW_R_AGKYDR3#19_attachment_110304.pdf](#).

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Witness Responsible:

James I. Warren

20. Reference: Rebuttal Testimony of James Warren. Does Mr. Warren agree that consolidated income tax adjustments do not violate the normalization requirements of the Internal Revenue Service?

Response:

Mr. Warren believes that the Internal Revenue Service last articulated its position regarding consolidated tax adjustments in September of 1991. At that time, the IRS stated that consolidated tax adjustments do not violate the depreciation normalization rules provided that they are applied only to the extent of current ratemaking tax expense and not to the deferred tax reserve applicable to accelerated depreciation on public utility property, and provided that the taxable income of any other regulated utilities used in the calculation of the adjustments is computed on a normalized basis. Mr. Warren is unaware of any subsequent pronouncement by the IRS on the subject.

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Witness Responsible:

James I. Warren

21. Reference: Rebuttal Testimony of James Warren. Does Mr. Warren agree that American Water Works claimed that there were benefits to filing a consolidated income tax return when it presented its organizational structure as part of the RWE acquisition?

Response:

Mr. Warren has no knowledge of any claims or representations made by American Water Works with regard to the RWE acquisition.

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Witness Responsible:

James I. Warren

22. Reference: Rebuttal Testimony of James Warren, page 8 line 8. Does Mr. Warren agree that the "actual taxes paid" used by Ms. Crane was used solely to determine the effective tax rate, and was not used in determining the actual income tax expense to include in rates?

Response:

If Ms. Crane intended to use the phrase "actual taxes paid" to mean something other than "actual taxes paid," Mr. Warren was and remains unaware of this intent.

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Witness Responsible:

Michael A. Miller

23. Reference: Rebuttal Testimony of Michael A. Miller, page 3, lines 8 to 10. Is Mr. Miller referring to 807 KAR 5:001 Section 10 (8) (c)?

Response:

Yes.

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Witness Responsible:

Michael A. Miller

24. Reference: Rebuttal Testimony of Michael A. Miller. Please provide a photocopy of the Order (or Orders) of the Kentucky Public Service Commission in which the Commission made findings of fact and rendered conclusions of law that Kentucky-American Water Company did not achieve its authorized ROE for Year 2002 or for Year 2003.

Response:

The Company knows of no such order. The Company's assertion is based on the audited financial statements of the Company.

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Witness Responsible:

Michael A. Miller

25. Reference: Rebuttal Testimony of Michael A. Miller, page 26, lines 24 through 28. Mr. Miller provides his conclusion that the Attorney General's proposal regarding CWIP and cash working capital has been made contrary to Kentucky law and PSC regulations. Is it the Company's position that Mr. Miller is competent (or otherwise qualified) to offer assessments and conclusion relating to Kentucky law and PSC regulations?

Response:

Mr. Miller in his role as Treasurer and Comptroller and through extensive experience in appearing before regulatory commissions is capable of forming an opinion based on the interpretations of commission regulations and prior commission orders. The Commission itself will be the body that determines if the AG witnesses positions are in line with Kentucky code, PSC regulations, and ultimately the outcome in this case. The Company stands by its testimony on this subject that the AG witnesses Dr. Woolridge and Ms. Crane's positions on the CWIP, working cash, and a number of other areas is not consistent with portions of Kentucky code, PSC regulations, and past Commission Orders.

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Witness Responsible:

Michael A. Miller

26. Reference: Rebuttal Testimony of Michael A. Miller. Is it Mr. Miller's opinion that the number of errors and omissions in the Company's application in Case No. 2004-00103 is greater than, less than, or equal to the number of errors and omissions in the Company's application for Case No. 2000-00120?

Response:

The Company has not attempted to go back and determine the number of corrections it made during the processing of its 2000 rate case. The processing of any rate case, whether it is forecasted test-year or historical test-year adjusted for known and measurable changes, is a complicated undertaking. None of the numerous rate cases that Mr. Miller has been involved with over the last 28 years have been perfect. There are always items that change during the case and yes there are omissions and errors on the part of all parties that are normally found and corrected during the process. This case was more complicated than the 2000 rate case because of the need to incorporate Tri-Village and Elk Lake into the files and to allocate corporate expenses to the three districts. This did create some situations where the links in the files did not work as well as we would have liked. The Company has corrected each area that has been brought to its attention by the other parties or found in its own review and supplied them to all the parties to the case. The Company believes the parties and the Commission have all the data in this filing and the extensive data requests on which to determine just and reasonable rates for the Company in this case.

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Witness Responsible:

Coleman Bush

27. Reference: Rebuttal Testimony of Coleman Bush, pages 6 and 7. Mr. Bush's response includes the following scurrilous and demagogic verbiage. "After the collaborative beginning to the tariff design, it is disappointing that we did not get more meaningful input from the Attorney General during this proceeding rather than coming down from the hills after the battle is over to simply shoot the wounded." Please answer the following.
- a. In OAG 1 – 18, the Company was asked to provide all hand-outs, presentations, notes, memoranda, and other documents in the Company's possession from each of the drought-pricing tariff meetings referred to in Q/A 18. Please confirm that June 16, 2000, is the most recent meeting for which materials are available.
 - b. Please confirm that June 16, 2000, is most recent meetings of the six meetings identified in Mr. Bush's prefiled testimony discussing the Company's effort to seek input during the "early stages" of the development of this tariff (Q/A 18).
 - c. Please confirm that the Office of the Attorney General did have a representative at the June 16, 2000, meeting.
 - d. Please provide a copy of any e-mail or letter from Kentucky-American to the Office of the Attorney General for the time period from June 16, 2000, to the date of the filing of Case No. 2004-00103, that invites the Office of the Attorney General to attend a meeting with representatives of Kentucky-American to discuss development of a drought pricing tariff or an emergency pricing tariff.
 - e. Please provide the first date on which Mr. Bush, another representative or agent of Kentucky-American, or Counsel for the Company provided the Office of the Attorney General with a copy of the Emergency Pricing Tariff submitted as part of Case No. 2004-00103 for the OAG's comments or input. Please also provide copies of any correspondence (from June 16, 2000, to the date of the filing of Case No.

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Coleman D. Bush

- 2004-00103) to the Office of the Attorney General relating to this matter and the dates of the subsequent transmissions of drafts or revisions of said Tariff to the OAG.
- f. In that Mr. Bush's Rebuttal Testimony readily concedes that Kentucky-American's provision of an opportunity to provide input (in the "early stages" of the process) relates to developing a **foundation** for the Emergency Pricing Tariff (page 6, line 32), please provide the date on which an employee of Kentucky-American, a representative of Kentucky-American, or one of its agents or Counsel contacted the Office of the Attorney General for the specific purpose of seeking input on the first draft of the Emergency Pricing Tariff proposal for Case No. 2004-00103 as part of the preparation of the pending application.

Response:

The language used to express my profound disappointment in the position taken by the Attorney General's witness that we had not fully thought through the proposed tariff was not intended to be, and was not, scurrilous or demagogic. I could have chosen other words to convey the concept but the analogy seems appropriate. All of the entities participating in this case should be interested in developing an emergency pricing tariff by making positive contributions to its development as opposed to suggesting that one cannot be crafted for an investor-owned utility because of cost and policy issues. Considerable time and effort was made in putting together the recommendation in multiple meetings where the Attorney General's office participated. Mr. Rubin suggests, in his testimony, that the Company has not thought through all of the complex public policy issues presented by this proposal and the Company has readily admitted that it does not have the foresight to recognize every nuance that will be presented in the event that this tariff should ever have to be

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Coleman D. Bush

implemented. However, the Company has spent a great deal of time thinking through the complex public policy issues associated with running out of water. The ideas generated in those meetings were sound and comprehensive then and today; the conditions giving rise to consideration of this tariff have not improved; we have reviewed the required programming of this tariff in detail and at significant expense. We should not let another summer arrive without this tariff in place.

- a. The reference should be to OAG 1 – 22. Confirmed.
- b. Confirmed.
- c. The notes provided earlier indicate that he was.
- d. - f. None.