

**COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION**

In the Matter of:

Adjustment of Rates of Kentucky-American Water Company ) Case No. 2004-00103  
  )

**ATTORNEY GENERAL'S RESPONSE TO  
LEXINGTON-FAYETTE URBAN COUNTY  
GOVERNMENT'S APPLICATION FOR REHEARING**

The Attorney General tenders his response to the Lexington-Fayette Urban County Government's ("LFUCG") Application for Rehearing. The Commission should deny the Application. The Attorney General states the following.

In its initial brief, LFUCG asked the Commission to adopt a special revenue allocation methodology solely for the public fire service class of customers. LFUCG's proposal would have reduced the rates paid by LFUCG, but LFUCG never identified which customer classes would pay higher rates as a result.

The Commission properly rejected LFUCG's proposal to single out one class of customers for a special revenue allocation. The Commission determined that it was unreasonable to LFUCG to receive a rate decrease when every other customer in the Central Division would receive a rate increase.

In its Application for Rehearing, LFUCG has filed yet another proposal with the Commission. This time, LFUCG is asserting that instead of the rate

reduction it argued for in its brief, it would settle for “only” receiving no rate increase. As was the case before, LFUCG again has not identified the customers who would pay higher rates as a result of LFUCG’s proposed special treatment.

In fact, it appears that LFUCG believes that all other customers would pay for its special rate. Thus, on page 7, LFUCG states: “Kentucky-American’s more than 100,000 other customers are only receiving a de minimis subsidy (approximately 20 cents per month) . . .”

But LFUCG’s premise is mistaken. If the same methodology advocated by LFUCG is applied to the other classes of customers in the Central Division, then the Residential Class (among others) also would be entitled to lower rates than the Commission developed by applying an across-the-board increase. Specifically, the same exhibit attached to LFUCG’s Application shows that, using LFUCG’s theory, the Residential Class should pay 53.2% of KAWC’s sales revenue. Yet the result of the Commission’s order is that the Residential Class will pay \$24,197,500, which is 54.3% of Central Division sales revenue of \$44,599,118. In other words, while LFUCG believes it is being overcharged by \$230,000, applying the same methodology to other customers means that the Residential Class is being overcharged by more than \$490,000.

This highlights the fundamental problem with LFUCG’s proposal: The same revenue allocation methodology is not being applied equally to all customer classes. If the methodology proposed by LFUCG were to be used for all classes, then the entire impact of providing lower rates for LFUCG would be

borne by the Commercial, Industrial, and Sales for Resale Classes, because they are the only ones provided a smaller percentage of revenue than the 2000 cost of service study shows. In other words, the “fair and balanced” application of LFUCG’s proposal – that LFUCG says it wants – is to lower its bills for fire protection service by increasing the water rates for business customers.

As the Commission recognized in its Order, there is no reason to reach such a result. The cost of service study is a **guide** – a useful piece of information – to allocating revenues and designing rates. The cost of service study does not provide the **answer**. The use of a cost of service study must be tempered with sound judgment by expert analysts (whom LFUCG did not present in this case) and by the Commission itself.

In the Commission’s decision, reasonable judgment prevailed. Cost of service and revenue allocation issues were not contested on the record of this case (the only proposal contrary to KAWC’s proposal was made, for the first time, in LFUCG’s brief). Every expert witness who addressed these issues agreed that an across-the-board allocation of the increase in the Central Division was reasonable in this case. LFUCG’s attempt to carve out a special exception for itself – without any support in the record – must be rejected.

While LFUCG is correct that the 4.0% figure does appear in KAWC’s cost of service study, the **consistent use and interpretation** of that figure should be the subject of expert testimony. The Commission does not simply take the cost of service revenue allocations and automatically use that to determine rates.

Reasonable judgment, considerations of fairness to all customers, rate continuity, and other factors all must play a part in determining just and reasonable rates.

The Commission's Order on revenue allocation reflects such a reasonable balancing of competing considerations. LFUCG's revised proposal, therefore, should be rejected.

Moreover, the Attorney General notes that LFUCG has mischaracterized the Attorney General's position in this case. The basis for the Attorney General's opposition to the low-income discount proposal was not a "spot ratemaking" proposal; rather, it was the absence of statutory authority for the Commission to authorize such a reduced rate plan. The basis for the Attorney General's advocacy on this point, therefore, was that the Commission is without discretion to authorize this discount proposal. This argument differs entirely from the argument of the LFUCG with regard to hydrants which, at best, is an argument that the Commission has abused its discretion.

Similarly, LFUCG also claims that the Attorney General's proposal for Northern District rates is a "rate design spot adjustment."<sup>1</sup> It is not. The Attorney General's Pre-filed Direct Testimony includes his proposal for each charge. Thus, he presented a complete recommendation including alternative schedules of rates and corresponding proofs of revenue.<sup>2</sup> Neither the Commission nor the parties were left to guess as to the impact of his

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<sup>1</sup> LFUCG's Application for Rehearing, page 11, footnote 22.

<sup>2</sup> See Direct Testimony of Scott J. Rubin, filed by the OAG on 27 August 2004.

recommendation for the Northern District upon the remaining rate payers. The position was subject to both discovery and cross-examination by all, including the LFUCG. The Attorney General's rate design recommendation for the Northern District was expressly based upon long-standing rate design principals, namely gradualism and rate continuity, that are applicable to this set of facts in light of the likelihood that Kentucky-American will seek to move toward single tariff pricing.<sup>3</sup>

The Attorney General's recommendation with regard to the rate design of the Northern District was fairly and fully disclosed, and justification for the impact of this rate design recommendation upon the other customers was based in sound rate-making principals. The Attorney General submitted ample "evidence of the consequence of the proposal" and made "recommendations for the development of the rate design of the other classes impacted by acceptance of the proposal."<sup>4</sup> In contrast, the LFUCG did not.

There is no inconsistency with regard to the Attorney General's proposal for the Northern District's rate design and his opposition to the LFUCG proposal due to the latter's failure to demonstrate "exactly what happens to Kentucky-American's remaining rate schedule under the LFUCG proposal,"<sup>5</sup> namely the impact of its proposal on other customers who would necessarily bear greater rate increases under the LFUCG proposal.

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<sup>3</sup> Direct Testimony of Scott J. Rubin, pages 16 and 17.

<sup>4</sup> See Reply Brief of the Attorney General, page 18.

WHEREFORE, the Attorney General respectfully requests this Commission deny the LFUCG Application for Rehearing.

Respectfully submitted,

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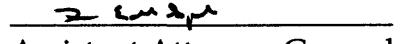
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<sup>5</sup> See Reply Brief of the Attorney General, page 18.

*Submission of Filing in Paper Medium*

Per Instructions 3 and 13 of the Commission's 27 May 2004 Order, Counsel submits for filing, by hand delivery to Beth O'Donnell, Executive Director, Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601, the original and one copy in paper medium of the document. 29 March 2005 is the date for the filing in paper medium.

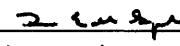
  
Assistant Attorney General

*Certificate of Service*

Per Instructions 4, 8 (d), and 12 of the May 27<sup>th</sup> Order, Counsel certifies service of a true and correct photocopy of the document by mailing the photocopies, first class postage prepaid, to the other parties of record on 28 March 2005.

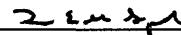
The following are the other parties of record: David Jeffrey Barberie, Leslye M. Bowman, Lexington-Fayette Urban County Government, Department of Law, 200 East Main Street, Lexington, Kentucky 40507; Coleman D. Bush, Kentucky-American Water Company, 2300 Richmond Road, Lexington, Kentucky 40502; Joe F. Childers, 201 West Short Street, Suite 310, Lexington, Kentucky 40507; Roy L. Ferrell, West Virginia American Water Company, 1600 Pennsylvania Avenue, Charleston, West Virginia 25302; Lindsey W. Ingram III, Stoll, Keenon & Park, LLP, 300 West Vine Street, Suite 2100, Lexington, Kentucky 40507-1801; Lindsey W. Ingram, Jr., Stoll, Keenon & Park, LLP, 300 West Vine

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Assistant Attorney General

*Certification Regarding Electronic Filing*

Counsel certifies that he has (per Instructions 3 and 8 (b) of the May 27<sup>th</sup> Order) submitted one copy of the document in electronic medium. Pursuant to Instructions 8 (a) and 8 (c) of the May 27<sup>th</sup> Order, he certifies that the electronic version of the filing is a true and accurate copy of the document filed in paper medium and that he has, by electronic mail, notified the Commission and the other parties that the electronic version of the filing has been transmitted to the Commission. 28 March 2005 is the date of filing in electronic medium.

  
Assistant Attorney General