COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ADJUSTMENT OF RATES OF KENTUCKY-AMERICAN WATER COMPANY	)	CASE NO. 2004-00103
	)	

LEXINGTON-FAYETTE
URBAN COUNTY GOVERNMENT'S REPLY BRIEF

Comes now the Lexington-Fayette Urban County Government (the "LFUCG"), by counsel, in accordance with the procedural schedule as amended, and submits this Brief in reply to the initial briefs filed by the parties, and in further support of its positions in this action.

I. THE PROPOSED ACQUISITION ADJUSTMENTS SHOULD BE DENIED

The Attorney General is correct, the proposed acquisition adjustments should be denied by the Commission. Kentucky-American Water Company ("Kentucky-American", or the "company") initially proposed two acquisition adjustments, a $208,310 acquisition adjustment for Tri-Village and a $106,123 adjustment for Elk Lake, which have now been increased (as the result of re-calculations and changes), to respectively, $222,197.24 and $112,497.10. The Attorney General has objected to both adjustments. (See, e.g., Kentucky-American Brief, at pages 10 through 11).

As part of its defense of the proposed acquisition adjustments (Kentucky-American Brief, at pages 10 through 14), the company cites to KRS 224A.300, and alleges that Kentucky-American is in a "unique position in the

Commonwealth." The company further claims that its motivation in making the underlying acquisitions is irrelevant. (Id. at 11.)

KRS 224A.300 does not mention Kentucky-American, and there exists no legislative act that affords it a "unique" status in the Commonwealth. The company's size and investor-owned status do not provide it with special rights and privileges that allow it to recover the costs of the premiums paid for its acquisitions from the existing ratepayers. If anything, the fact that Kentucky-American is the only major water company in Kentucky with a profit motive requires the Commission to review its acquisitions with a higher level of scrutiny when it seeks to recover an acquisition premium from its current ratepayers.

Although the company cites its merger with RWE AG as a reason favoring acquisition adjustments, the opposite holds true. The very nature of this former American Water Works Company is changing as a result of the merger. RWE AG's affiliates, including Kentucky-American, are under increasing pressure to grow and make acquisitions. As previously noted by the LFUCG, even the current staffing at Kentucky-American dramatically illustrates this new emphasis on business development, lobbying and "communications". (See LFUCG Brief, at pages 19 through 23). Kentucky-American is well aware that it faces no significant competition for acquisitions from outside the Commonwealth. (See Supplemental Response to Question No. 176, Attorney General's First Request for Information (Attachment) at page 11 of 69). There is simply no rational purpose for the Commission to allow the Company to recover premiums paid for

other entities. If these acquisitions cannot stand on their own merit, then the company -- not the existing customers -- must bear the financial burden.

The record in this case demonstrates that this is a very real issue. Kentucky-American has been in the process of acquiring Owenton for more than a year. It has repeatedly refused to provide any meaningful information on this acquisition, but intends to raise Owenton's rates when it finally does acquire it. (See Supplemental Response to Question No. 176, Attorney General's First Request for Information (Attachment) at page 61 of 69). Will an acquisition adjustment for Owenton be next? It is highly likely, if the Commission determines that acquisition adjustments are a given because of the company's "unique position" in the Commonwealth. The Company intends to purchase East Clark Water District in 2006. (See Supplemental Response to Question No. 176, Attorney General's First Request for Information (Attachment) at page 64 of 69). What reasonable limitation will exist on the acquisition cost if Kentucky-American can effectively recover any premium that it decides to pay from its current ratepayers?

If the company's current ratepayers are to be protected, the Commission must make it clear to Kentucky-American that acquisition adjustments are not routine, but rather require substantial justification in the public interest. Despite the company's studied claim of ignorance as to how its rates compare to other water providers in the Commonwealth, it is clear that it is a high cost provider of water.

The company's current rates are higher than most other providers in Central Kentucky. (See, e.g., LFUCG Exhibit No. 1 to Question No. 5(c), LFUCG's Supplemental Requests for Information Pertaining to Rebuttal Testimony). The company provides water at rates significantly higher than those charged by the only other water utility of comparable size in the Commonwealth, the Louisville Water Company[1]. If Kentucky-American cannot acquire and operate other systems at a profit within its current rates, its acquisitions should not be subsidized by its existing customers.

Therefore, the LFUCG respectfully requests that the Commission adopt the Attorney General's recommendation that the proposed acquisition adjustments be denied; and further, that the Commission specifically find that the company's "unique position" in the Commonwealth does not afford it any favorable treatment with respect to the premiums it decides to pay for acquisitions, and that such adjustments will not be granted in a routine manner.

II. THE COMPANY HAS VIOLATED ITS ESPOUSED PRINCIPLE OF "COST-BASED REVENUES" IN ITS PROPOSED TREATMENT OF PUBLIC FIRE HYDRANTS

The Company believes that the "most basic ratemaking principle is that revenues should be cost based." (See Kentucky-American Brief, at page 9). The LFUCG agrees in large part. However, when it comes to the proposed

[1] The tariffs for the Louisville Water Company as of January 1, 2005 are publicly available at http://www.louisvillewater.com/FAQ/2005%20RATE%20CHARTS.doc. It should be noted that although the company is appalled at the idea of a comparison of its water rates with the rates of other water suppliers, it has no problem with advising its customers of how low their rates are compared to the cost of "other utilities", presumably gas, electric, cable, etc. – a comparison of stunning irrelevance. See Responses to Questions No.'s 18 and 19, LFUCG's Supplemental Request for Information.

assignment of revenues in this case, and in particular, those assigned to public fire protection, the company violates this principle. Therefore, the LFUCG respectfully requests that the Commission limit any recovery from public fire protection to no more than the 4.0 percent of revenues supported by the company's own cost of service study. (See, LFUCG Brief, at pages 3 through 7). Any other determination will violate this ratemaking principle and penalize the LFUCG and other public fire protection providers.

III. THE COMPANY CANNOT MIX HISTORIC AND FUTURE TEST YEARS IN ORDER TO BENEFIT ITS SHAREHOLDERS

The Company is permitted by statute to use a forecasted test period for its rate filings. However, it must choose either an historic test period or a forecasted period, not a mixture of both. Further, the Company is not relieved of the consequences of its choice merely because it has the right to choose one approach or the other.

Kentucky-American employs both approaches in this proceeding, which harms the ratepayers. For instance, the company seeks to recover substantial historic costs through "accruals" -- while forecasting its actual costs for the period when the rates will actually be in effect. It dismisses the Attorney General's reasoned forecasts as "guesses"[2] -- while elevating its own guesses to the level of certainties. The company has had to correct numerous significant

[2] See, Kentucky-American Brief, at pages 30, 32.

factual errors that it forwarded during this proceeding[3], yet castigates the Attorney General's witnesses for alleged erroneous conclusions -- which are claimed to be based on the inaccurate information provided by the company. (See, e.g., Miller Rebuttal Testimony at page 28). Kentucky-American has generated further confusion because of its seemingly contradictory positions regarding its desire to pursue both an Emergency Pricing Tariff (the company wants it, then it doesn't want it, then finally wants it) and an Economic Development Tariff (the company proposed it, but doesn't want it yet). It criticized the parties for "misunderstanding" Mr. Jarrett's pre-filed testimony[4], which was clear on its face, but which has now taken on a different meaning.

The number of errors, omissions, inaccuracies and confusing statements provided by Kentucky-American in this proceeding is of further significance because it has demanded the recovery of rate case expenses at an historic level. The company initially blamed its ballooning costs on the LFUCG -- for asking what it deemed "irrelevant" questions.[5] Now the company apparently discards this accusation while citing other factors.[6]

Kentucky-American has the burden of proof in this case. The reliability of the information it has provided in this case is a concern. Its projections cannot

[3] See, for instance, the eleven changes described beginning at page 5 of Kentucky-American's Brief.

[4] See Kentucky-American Brief, at page 33.

[5] As pointed out in the LFUCG's Brief, this claim is without merit. See, e.g., LFUCG Brief, at page 2.

[6] See Kentucky-American Brief, at page 39.

be deemed "forecasts" while other reasoned projections are reduced to "guesses". The company should not be able to escape its responsibility (and liability) for providing inaccurate information by simply updating it at the last moment.

Most significantly, Kentucky-American must not be permitted by the Commission to manipulate the forecasted test year approach by employing a mixture of approaches that is not contemplated or sanctioned by under the law. The Attorney General has rightly and reasonably pointed out a number of instances in which such inconsistent treatment is present in the company's recommendations. The LFUCG respectfully requests that the Commission adopt the Attorney General's recommendations and not permit the Company to profit from its use of a hybrid filing approach that is neither sanctioned nor permitted by Kentucky law.[7]

IV. THE COMPANY'S POSITION ON CONDITION NO. 2 IS NOT SUPPORTABLE

The company claims that the only "reasonable interpretation" of Condition 2 in Case No. 2002-00018 is that Kentucky-American was allowed to accrue security costs to recover in its next rate case, thereby opining that anyone reviewing the condition should have known that recovery was allowed in this manner. (See Kentucky-American Brief, at page 23).

[7] To the extent that some of the Attorney General's suggestions represent a departure from prior Commission practice, the suggestions provide a balanced and reasoned basis for such departures.

This flies in the face of the fact that even the Commission staff did not share this interpretation. (See Letter of October 15, 2003, from Thomas Dorman, Executive Director, to Lindsay Ingram). In order to adopt the company's position on this issue one must also assume that Condition No. 2 only delayed the recovery of ***higher*** costs from ratepayers, which is clearly unreasonable.

The conditions imposed in Case No. 2002-00018 were held to be necessary to protect the ***public interest***, not merely to increase public acceptance of the narrowly-approved merger. Therefore, the LFUCG respectfully requests that the Commission reject this proposed accrual for this reason, and for the additional reasons provided in its Brief.

V. CONCLUSION

For the reasons provided above and in the LFUCG's Brief, Kentucky-American is not entitled to a rate increase in the amount sought, nor should the allocation of any rate increase be unfairly borne by the public fire hydrant classification. Therefore, the LFUCG respectfully requests that the Commission provide the relief requested in its Brief and limit the company's requested rate increase as appropriate.

Respectfully submitted,

LEXINGTON-FAYETTE URBAN
COUNTY GOVERNMENT
Department of Law
200 East Main Street
Lexington, Kentucky 40507
(859)258-3500

BY: /s/ David J. Barberie
David J. Barberie
Corporate Counsel
dbarberi@lfucg.com
Leslye M. Bowman
Director of Litigation

CERTIFICATION

In accordance with the Commission's procedural orders the undersigned counsel hereby certifies that the original and one copy of the foregoing document have been filed by United States Mail, first class postage prepaid, to Elizabeth O'Donnell, Executive Director, Public Service Commission, 211 Sower Boulevard, P.O. Box 615, Frankfort, Kentucky 40602-0615, and by uploading the document to the file transfer protocol site designated by the Commission. The undersigned counsel hereby certifies that the electronic version is a true and accurate copy of the document(s) filed in paper medium, the electronic version has been transferred to the Commission, and the Commission and other parties have been notified by electronic mail that the electronic version has been transmitted to the Commission. Undersigned counsel also certifies that a copy of the foregoing was served by first class U.S. Mail delivery, postage prepaid, on the following, all on this the 11th day of January 2005:

Nick Rowe (Roy W. Mundy II)
President, and
Mr. Coleman D. Bush
Director Business Development
Kentucky-American Water Company
2300 Richmond Road
Lexington, KY 40502
rwmundy@kawc.com
cbush@kawc.com

Hon. David Edward Spenard, and
Hon. Dennis Howard
Assistants Attorney General
Office of the Attorney General
Utility & Rate Intervention Division
1024 Capital Center Drive
Suite 200
Frankfort, KY 40601-8204
David.Spenard@ag.ky.gov
Dennis.Howard@ag.ky.gov

Roy L. Ferrell, and
Michael A. Miller
West Virginia
American Water Company
1600 Pennsylvania Avenue
Charleston, WV 25302
rferrell@wvawater.com
mmiller@wvawater.com

Joe F. Childers, Esq.
Attorney
201 West Short Street
Suite 310
Lexington, KY 40507
childerslawbr@yahoo.com

Lindsey W. Ingram, Jr., Esq. and
Lindsey W. Ingram, III, Esq.
Stoll, Keenon & Park, LLP
300 West Vine Street
Suite 2100
Lexington, KY 40507-1801
ingramjr@skp.com
ingram3@skp.com

Foster Ockerman, Jr.
MARTIN, OCKERMAN & BRABANT
200 N. Upper St.
Lexington, Kentucky 40507
ockerman@kycounsel.com

/s/ David J. Barberie
ATTORNEY FOR LEXINGTON-FAYETTE
URBAN COUNTY GOVERNMENT

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