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BEFORE THE
COMMONWEALTH OF KENTUCKY
PUBLIC SERVICE COMMISSION

IN THE MATTER OF:

ADJUSTMENT OF THE RATES OF
KENTUCKY-AMERICAN WATER COMPANY

CASE NO. 2004-00103

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COMMISSION

TRANSCRIPT OF EVIDENCE

VOLUME II

DATE OF HEARING: November 9, 2004

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CHAIRMAN GOSS:

Good morning, everyone. Please be seated. Thank you.
All right. We'll be back on the record. Any matters
to take up, Counsel, before Kentucky-American continues
with its case? Okay. Mr. Ingram, you may proceed,
sir.

MR. INGRAM:

I call Jim Warren, Your Honor.

CHAIRMAN GOSS:

Jim Warren?

WITNESS SWORN

CHAIRMAN GOSS:

Mr. Ingram?

The witness, JAMES I. WARREN, after having been
first duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. INGRAM:

Q. Would you state your name, please?

A. My name is James I. Warren.

Q. What is your business address?

A. My business address is 875 Third Avenue, New York, New
York.

Q. What is your profession?

A. I'm an attorney.

Q. Do you have a specialty?

1 A. Yes, I do. I'm a tax attorney and my specialty within
2 the area of taxation is the taxation of utilities.

3 Q. Which is probably why you're here today; right?

4 A. Why I'm here today.

5 Q. Have you filed your direct testimony in this case?

6 A. Yes, I have.

7 Q. If I asked you the questions contained therein today,
8 would you give me the same answers?

9 A. I would.

10 MR. INGRAM:

11 That's all I have at this time, Your Honor.

12 CHAIRMAN GOSS:

13 Thank you, Mr. Ingram. Mr. Spenard, would you
14 like to cross?

15 MR. SPENARD:

16 Yes, Your Honor.

17 CROSS EXAMINATION

18 BY MR. SPENARD:

19 Q. Good morning, Mr. Warren.

20 A. Good morning.

21 Q. Does Kentucky-American Water Company file an income tax
22 return as part of a consolidated income tax group?

23 A. It's my understanding that they do.

24 Q. Do you have an understanding as to why the decision was
25 made to have Kentucky-American file an income tax

1 return as part of a consolidated group?
2 A. I have not discussed that specifically with the
3 company, but most similarly situated entities do that.
4 Q. Okay. Did Kentucky-American Water Company file a
5 consolidated income tax return prior to the acquisition
6 of American Water Works by RWE?
7 A. Again, it's my understanding that they did.
8 Q. Okay. On Page 5 of your testimony, in the rebuttal,
9 you discussed the methodology used by Ms. Crane to
10 develop her consolidated income tax adjustment . . .
11 A. Just a second. Let me get a copy of my testimony.
12 Q. Yes, sir.
13 A. I'm sorry. Would you repeat the question, please?
14 Q. Yes, sir. Referring to Page 5 of your testimony, . . .
15 A. I'm there.
16 Q. Okay. You discuss the methodology used by Ms. Crane to
17 develop her consolidated income tax adjustment.
18 A. Yes, I see that.
19 Q. Would you agree that the methodology used by Ms. Crane
20 is based on the methodology adopted by the Pennsylvania
21 Public Utility Commission?
22 A. My recollection is it's similar, if not the same, but I
23 haven't specifically looked at the Pennsylvania
24 methodology for some substantial period of time.
25 Q. Okay. If Kentucky-American filed a stand-alone federal

1 income tax return and it had a taxable loss in a
2 particular year, would it be able to utilize that tax
3 loss in subsequent years?
4 A. It is your hypothetical that it always filed an
5 unconsolidated tax return?
6 Q. Yes, sir.
7 A. So both prior to the year you're hypothesizing and
8 thereafter it would file a stand-alone return?
9 Q. Yes, sir.
10 A. It may or may not. It depends on the level of taxable
11 income in the prior years and in the subsequent years.
12 Q. Okay. Well, would the tax loss carry-forward be
13 available to Kentucky-American if it filed a stand-
14 alone federal income tax return?
15 A. Assuming that it wasn't absorbed in carrying back
16 against prior years' taxable income, yes, it would.
17 Q. Well, what are the tax laws regarding the timing of the
18 use of tax loss carry-forwards in general?
19 A. In carry-forwards?
20 Q. Yes, sir.
21 A. The tax loss carry-forwards are available to offset
22 taxable income for the subsequent 20-year period.
23 Q. Okay. Let's assume that Kentucky-American files as
24 part of a consolidated income tax group and that it has
25 a tax loss in a particular year. Okay? And further

- 1 assume that the overall group has net taxable income in
2 that year. What happens to Kentucky-American's tax
3 loss under that scenario?
- 4 A. If it files separately?
- 5 Q. No, sir, if it files as part of a consolidated income
6 tax group.
- 7 A. I'm sorry. Please repeat the question one more time.
- 8 Q. Yes, sir. Okay. We're going to move to a different
9 hypothetical.
- 10 A. Okay.
- 11 Q. Let's assume that Kentucky-American files as part of a
12 consolidated income tax group.
- 13 A. All right.
- 14 Q. And that in a particular year it has a tax loss. Now,
15 if the overall group had net taxable income in that
16 year, what would happen to Kentucky-American's tax loss
17 under that scenario?
- 18 A. It would be netted against the taxable income of all
19 members.
- 20 Q. Okay. Let's continue to assume that Kentucky-American
21 files as part of a consolidated income tax group and it
22 has a tax loss in a particular year. If the overall
23 consolidated group has a taxable loss, what happens to
24 Kentucky-American's tax loss in that scenario?
- 25 A. Kentucky-American has a tax loss and the group has a

1 tax loss?

2 Q. Yes, sir.

3 A. It becomes a component of the overall tax loss carry-
4 forward or carry-back.

5 Q. Okay. Referring to Page 8 of your testimony, . . .

6 A. I'm there.

7 Q. Okay. On Lines 7 and 8 of your testimony, you discuss
8 Ms. Crane's reference to, quote, "actual taxes paid."
9 Do you see that?

10 A. I do.

11 Q. Is it your understanding that Ms. Crane included the
12 actual taxes paid during the past three years in her
13 revenue requirement calculation?

14 A. Yes. Her computation would have been based on the
15 taxes that the group actually paid.

16 Q. Okay. Was the analysis of the actual taxes paid to
17 determine the appropriate effective income tax rate to
18 apply to Kentucky-American's pro forma operating
19 income, taxable income?

20 A. An effective tax rate is not a function of the tax law.
21 The tax law taxes income, taxable income, and taxes it
22 all at the same rate. The effective tax rate is a
23 creature of after-the-fact analysis, just a ratio to
24 determine what the effect of taxing everybody's taxable
25 income at the statutory rate is.

1 Q. Is it your understanding that Ms. Crane utilized the
2 past three years in order to determine an effective
3 income tax rate?
4 A. That's what she claims to have done.
5 Q. Okay. On Page 10 of your testimony, . . .
6 A. I'm there.
7 Q. . . . Lines 11 through 13, . . .
8 A. Yes.
9 Q. . . . you discuss what you call a principle of
10 determining which member is most responsible for
11 producing the tax benefit or incurring the tax cost.
12 A. Yes.
13 Q. Okay. In determining the income taxes payable by a
14 consolidated income tax group, does the Internal
15 Revenue Service distinguish between which group member
16 generated the loss?
17 A. There is one consolidated tax due with respect to the
18 group, but each and every subsidiary is severally
19 allowable for the entire amount. So it can be imposed
20 on any one of the group.
21 Q. So the IRS does not distinguish between the group
22 members?
23 A. It doesn't much care where it gets its money.
24 Q. Okay. So, as acknowledged on Page 10, Lines 16 through
25 19 of your testimony, the IRS does not identify which

1 single group member is definitely and exclusively
2 responsible for a particular tax outcome?
3 A. No. As I said, the Internal Revenue Code taxes all
4 taxable income at 35 percent.
5 Q. Okay. Let's assume that Kentucky-American has an
6 operating cost that is largely outside of its control.
7 Let's use gasoline for its vehicles. If the Commission
8 knew that the cost of gasoline was going to decline
9 in the forecasted period and remain low, should the
10 Commission recognize this fact in setting rates?
11 A. The general treatment of costs in regulation isn't
12 really my area of expertise. I would be guessing,
13 but, you know, I would assume, if you use a forecast
14 test period, you try to forecast what the costs will
15 be.
16 Q. Okay.
17 A. But that, of course, would be a cost that was related
18 to the actual furnishing of the service.
19 Q. Okay. Let's move to Page 13 of your testimony.
20 A. All right. I'm there.
21 Q. Okay. You discuss compensation to companies generating
22 tax losses.
23 A. I see that; yes.
24 Q. Okay. Does this mean that Kentucky-American pays to an
25 affiliate that generates a tax loss the difference

1 between Kentucky-American's taxes that's at the
2 statutory tax rate and the taxes at the effective tax
3 rate?

4 A. It's my understanding that Kentucky-American pays to
5 its parent a level of tax that is associated with its
6 taxable income.

7 Q. If the parent collects more than it pays to the
8 Internal Revenue Service for taxes, what does it do
9 with the excess?

10 A. If the parent?

11 Q. Yes.

12 CHAIRMAN GOSS:

13 Would you - collect some more from what source?
14 Would you - I'm not sure I understand your
15 question. I'm not sure he does either.

16 MR. SPENARD:

17 Yes, sir. Sure. The subsidiaries are sending
18 money to the parent . . .

19 CHAIRMAN GOSS:

20 Right. Well, is that what you mean; from the
21 subsidiaries?

22 MR. SPENARD:

23 Yes, sir.

24 CHAIRMAN GOSS:

25 Okay. All right. I just wanted to be clear of

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your question, because I'm interested in this.

MR. SPENARD:

Sure.

CHAIRMAN GOSS:

Go ahead.

Q. If the parent collects more than what it ultimately pays to the Internal Revenue Service, what happens to that extra money?

A. Let me respond to that on a generalized basis, because I'm not specifically knowledgeable with respect to what the American Water Works group does, but what normally happens is the companies that owe tax on a separate basis pay that up to the parent. The parent then, to the extent that there are companies who have produced losses that reduce the aggregate tax liability, fund those companies with the tax reduction effects of those losses and, if those are the only - if losses and income are the only two things operating - there could be others, but, assuming that those are the only two factors, then the sum of the parts will equal the whole.

Q. Okay. Are you aware in the early nineties there was some disagreement among regulatory commissions about whether consolidated income tax adjustments violated the normalization provisions of the Internal Revenue

1 Service?

2 A. The disagreement is between who? I'm sorry.

3 Q. Whether there was some disagreement among regulatory
4 commissions about whether consolidated income tax
5 adjustments violated the normalization provisions of
6 the Internal Revenue Service.

7 A. That's not precisely how I would describe it, but there
8 certainly was a controversy between the Internal
9 Revenue Service position, the regulatory community, and
10 the utility community regarding that issue.

11 Q. Okay. If I'm correct, if consolidated income taxes
12 were found to violate the normalization provisions of
13 the Internal Revenue Service, then utilities subject to
14 consolidated income tax adjustments were in danger of
15 losing the ability to utilize accelerated depreciation;
16 is that correct?

17 A. That is correct.

18 Q. Okay. Would you agree with me that, as a result of
19 this uncertainty, regulatory commissions were reluctant
20 to adopt consolidated income tax adjustments?

21 A. There were a few commissions that engaged in the
22 controversy; most never broached the topic. I can't
23 speak for what the motivation - you know, proving the
24 negative with regard to why regulators didn't act is
25 beyond what I'm capable of.

1 Q. Yes, sir. Have you reviewed the information that the
2 Attorney General's Office provided in response to the
3 data request to both Kentucky-American and the Public
4 Service Commission?
5 A. Which specific material?
6 Q. This would be the Attorney General's Response to the
7 PSC's Information Request, Item 58.
8 MR. INGRAM:
9 Is that PSC 4-58?
10 MR. SPENARD:
11 No, sir. This would be the Attorney General's
12 Response to the . . .
13 A. I don't know that I have - can you describe what the
14 material is?
15 (WITNESS WAS PROVIDED THE RESPONSE)
16 A. Yes, I have reviewed this.
17 Q. Okay. So you're familiar with the Statement by Michael
18 Graetz, Deputy Assistant Secretary for Tax Policy?
19 You're familiar with the Statement that the office
20 provided in response to PSC Item 58?
21 A. I actually attended this hearing.
22 Q. Okay. Am I correct that this Statement includes a memo
23 discussing consolidated income tax adjustments?
24 A. Yes. There was a memo from the IRS Chief Counsel that
25 was appended to this.

1 Q. Will you turn to Page 6 of that memorandum?
2 A. I am there.
3 Q. Okay, and I ask you to read the first sentence of the
4 second paragraph on that page, beginning with,
5 "Therefore, ..."
6 A. "Therefore, it is the current ruling position of the
7 Internal Revenue Service that consolidated tax
8 adjustments, as a general rule, are not inconsistent
9 with the normalization requirements of the Code."
10 Q. Okay.
11 MR. SPENARD:
12 This has already been provided to the Commission
13 in response to a data request, but, in terms of
14 hearing exhibits, we're going to tender this as a
15 hearing exhibit and ask that it be marked AG
16 Hearing Exhibit 1.
17 CHAIRMAN GOSS:
18 Any objection?
19 MR. INGRAM:
20 No, Your Honor.
21 CHAIRMAN GOSS:
22 All right. Let it be marked, then.
23 AG EXHIBIT 1
24 Q. You mention in your testimony four states that have
25 consolidated income tax adjustments; Pennsylvania, New

1 Jersey, West Virginia, and Texas. Is that correct?

2 A. Yes.

3 Q. Okay. Do you know what percentage of American Water
4 Works' regulated water and sewer customers are located
5 in these four states?

6 A. No, I have no idea.

7 Q. Okay.

8 MR. SPENARD:

9 One moment, please.

10 OFF THE RECORD

11 CHAIRMAN GOSS:

12 Mr. Spenard, can I ask you, this exhibit that
13 you've got here, who prepared this? I mean,
14 what . . .

15 MR. SPENARD:

16 Yes, sir. It is . . .

17 CHAIRMAN GOSS:

18 I understand this is in an answer to a data
19 request, but I'm trying to figure out who prepared
20 this or who authored this.

21 MR. SPENARD:

22 This was prepared for Michael Graetz, Deputy
23 Assistant Secretary for Tax Policy, from Abraham
24 Shashy, the Chief Counsel, and, if it's your
25 request, we'll make a photocopy of the

1 entire . . .

2 CHAIRMAN GOSS:

3 No, that's not necessary. I was just wondering
4 where . . .

5 MR. SPENARD:

6 Oh, sure.

7 CHAIRMAN GOSS:

8 Is this what the witness indicated came from IRS
9 Counsel, General Counsel?

10 MR. SPENARD:

11 Yes, sir.

12 CHAIRMAN GOSS:

13 Okay. All right. That's fine.

14 MR. SPENARD:

15 Okay.

16 Q. Mr. Warren, in preparing your testimony, did you review
17 - you reviewed some of the materials that were supplied
18 for this case; is that correct? Data responses, for
19 example, did you review any of the data responses that
20 the Attorney General supplied to Kentucky-American?

21 A. Yes. Certainly, this one, No. 58, I reviewed.

22 Q. Okay.

23 A. I can't recall which other ones I reviewed, but a few,
24 certainly.

25 Q. Did you review any of the Orders issued by the Public

1 Service Commission regarding Kentucky-American?

2 A. By this Commission?

3 Q. Yes, sir.

4 A. I don't recall that I did.

5 Q. Okay. Thank you, Mr. Warren.

6 MR. SPENARD:

7 At this stage, we have no further questions.

8 CHAIRMAN GOSS:

9 Okay, Mr. Spenard. Thank you. Mr. Childers, Mr.
10 Barberie, Mr. Ockerman, do you all have any
11 questions?

12 MR. CHILDERS:

13 No questions.

14 MR. BARBERIE:

15 No questions.

16 MR. OCKERMAN:

17 No questions, Your Honor.

18 CHAIRMAN GOSS:

19 All right. Mr. Wuetcher?

20 MR. WUETCHER:

21 Thank you, Your Honor. We have a few.

22 CROSS EXAMINATION

23 BY MR. WUETCHER:

24 Q. Good morning, Mr. Warren.

25 A. Good morning.

1 Q. Let me start out by referring to Page 4 of your
2 rebuttal testimony. You stated that, to your
3 knowledge, the Kentucky Commission has never imposed a
4 consolidated tax adjustment. I assume that, since you
5 have filed your rebuttal testimony, you've become aware
6 of the Commission's decision in Case No. 2001-00092
7 involving the Union Light, Heat & Power Company?
8 A. Well, the answer to that is probably. I did read a
9 Union Light Order and it involved, I guess, the use of
10 a Kentucky state tax rate. Is that the one to which
11 you're referring?
12 Q. Yes, sir.
13 A. I did . . .
14 Q. So you're somewhat familiar with it?
15 A. I did pull that off the website and read that.
16 Q. Okay. To the extent that you're aware of that Order,
17 does that in any way change any of the statements that
18 you make at Page 4 of your testimony?
19 A. No. No, it doesn't. State taxes are quite different
20 in most instances from federal taxes. State taxes -
21 federal taxes are unidimensional; you have losses and
22 you have income, and, by and large, that's the only
23 calculus - those are the only factors that enter into
24 the calculus. State, you have income and losses. You
25 have apportionment factors which involve sales,

1 property, payroll. In different states, you have
2 apportionment factors. There are at least four
3 different factors that determine the level of taxation.
4 So, in this regard, in the particular regard of trying
5 to determine, as I call it, responsibility, federal
6 taxes are pretty straightforward; state taxes are much
7 more complicated.

8 Q. Just for discussion purposes, I'm going to refer to
9 that Union Light, Heat & Power Order. In that case,
10 the use of a consolidated tax return resulted in a
11 decrease in the state tax rate from 8.25 percent to an
12 effective state tax rate of 3.03 percent. If the
13 consolidated federal income taxes of American Water
14 Works Company has a similar effect to the effective
15 federal tax rate, then why should the Commission impute
16 taxes on the stated tax rate of 35 percent rather than
17 the effective tax rate?

18 A. Let me address that by maybe a simple example. Would
19 that be all right?

20 Q. That would be fine.

21 A. If you have one company that operates in Kentucky and
22 all the rest of your group operates elsewhere and you
23 file a Kentucky consolidated tax return, you're going
24 to combine everybody's income and then you're going to
25 apportion it based on all of these factors, a ratio of

1 Kentucky sales versus total sales, a ratio of Kentucky
2 property versus total property, a ratio of Kentucky
3 payroll versus total payroll, to come up with a taxable
4 income number based on all of those allocations that
5 they're going to subject a tax in Kentucky. So they
6 come up with some - obviously, you wouldn't file a
7 consolidated Kentucky return unless it reduced the
8 number below the Kentucky statutory rate, and, in the
9 Union Light case, it obviously did have that effect.
10 Now, you've got all these other companies that have no
11 connection to Kentucky and wouldn't have been subject
12 to Kentucky tax anyway. They could have had no benefit
13 from their status. Kentucky was not going to send them
14 a check for their losses or their - there was no
15 benefit that they had to ascribe to their status, but,
16 when you combined it together, it did have an impact on
17 the entity that was subject to Kentucky tax. Now,
18 that's what happens in Union Light. For federal
19 purposes, it's completely different, because one
20 company will have a loss, another company will have
21 income, and there will be a discrete benefit associated
22 with that loss that that company will be deprived of if
23 they're netted and it's not compensated for that loss.
24 I mean, it will be subject to federal tax as opposed to
25 the situation where you have all these companies that

1 had no Kentucky liability or benefit under any
2 circumstances, and so it's just, in a Kentucky
3 consolidated situation, it's just a way you come up
4 with the taxable income subject to Kentucky tax
5 whereas, in federal, they're individual tax
6 liabilities.

7 Q. Let me refer you to the Attorney General's consolidated
8 income tax adjustment, which I think it's found at
9 Schedule ACC-39 of Ms. Crane's testimony.

10 A. Excuse me for just a second while I get that.

11 MR. INGRAM III:

12 Would you say again, Mr. Wuetcher, where
13 you're . . .

14 MR. WUETCHER:

15 I'm referring to Schedule 39 of Ms. Crane's
16 direct testimony.

17 Q. I primarily just want you to have that in front of you.
18 I have just one question on it.

19 A. Sure. Schedule ACC-1?

20 Q. ACC-39.

21 A. Oh, 39. I'm sorry. I have it now.

22 Q. That's okay. We may have produced a lot of work for
23 what will be a very simple answer. Does the
24 consolidated methodology proposed by Ms. Crane allocate
25 the tax losses of the non-regulated companies to

- 1 Kentucky-American based upon the ratio of Kentucky-
2 American's taxable income to the total positive taxable
3 income of the regulated and non-regulated subsidiaries?
- 4 A. Yes.
- 5 Q. If a consolidated income tax adjustment were to be made
6 by the Commission, would the use of the effective
7 federal tax rates paid produce a more accurate result
8 than the allocation method proposed by Ms. Crane?
- 9 A. Could you repeat that question?
- 10 Q. Okay. If a consolidated income tax adjustment were to
11 be made by the Commission, would the use of the
12 effective federal tax rates paid produce a more
13 accurate result rather than the allocation method
14 proposed by Ms. Crane?
- 15 A. Are you proposing that there be a - it's not such a
16 simple question. Are you proposing that there be an
17 average of three years of effective tax rates? This
18 proposal uses three different tax years and does an
19 allocation of losses and takes an average of them, of
20 the three years. Is that what you're comparing this
21 to?
- 22 Q. Well, let's - actually . . .
- 23 A. And there are many other ways to do a consolidated
24 return, consolidated adjustments.
- 25 Q. Well, no, you're adding a greater level of complexity

1 than what I'm suggesting, but that's fine.

2 A. Okay.

3 Q. Let's assume for the moment that you used - let's

4 disregard whether it was three years or just one.

5 Assuming for the moment the Commission simply proposed

6 to make that type of an adjustment of a consolidated

7 income tax adjustment, notwithstanding whether you used

8 a three-year averaging or just a one-year figure, would

9 the allocation method that Ms. Crane proposed produce a

10 more accurate result than just using the effective

11 federal tax rates?

12 A. Okay. Let me answer in two pieces. I'll try to make

13 it simple.

14 Q. Sure.

15 A. I think what her methodology does - and I'm doing this

16 without a net, not doing the math - I think it creates

17 an effective tax rate but applies it to the currently

18 payable. If you used an overall effective tax rate and

19 applied it to tax expense in total, I think that would

20 be a problem because you would be applying an effective

21 tax rate both to currently payable taxes and deferred

22 taxes, and you can't do that. Her methodology focuses

23 - makes an adjustment just for the effect on currently

24 payable, I believe, and is not meant to apply to

25 deferred. I think that's an accurate statement. So,

1 again, going back to your question, I think her
2 methodology would create, in any single year, would
3 create an effective tax rate to be applied to the
4 current portion of tax expense but not to the deferred
5 portion of tax expense, and I think that, if - and
6 obviously I disagree with, in closing, such an
7 adjustment at all, but, if you were going to impose an
8 adjustment and you decided it was going to be a cost of
9 service adjustment rather than rate base adjustment and
10 if you were going to presume that these were represent-
11 ative numbers, you would only apply - her methodology
12 does - what her methodology does would be, from a tax
13 normalization perspective, permissible, but I think
14 would come to the same result as using an effective
15 rate applied to the current portion. I believe that
16 would be they're mathematically the same. That wasn't
17 so simple; was it?

18 Q. I think you answered the question to our satisfaction,
19 but . . .

20 A. Okay. I'm sorry.

21 Q. . . . that now leads us to request some additional
22 information, which I don't believe you can provide from
23 the stand, so I will ask if the company could provide
24 or if you could provide within a reasonable time the
25 calculation of American Water Works' effective federal

1 income tax rates for the calendar years 2001, 2002, and
2 2003 and provide, with those effective income tax
3 rates, your work papers, all assumptions, and
4 calculations used to derive those rates.

5 A. You know, again, an effective tax rate is not a tax
6 term; it's a construct. Basically, you tax all taxable
7 income at 35 percent. That's what the tax law does,
8 and, if you have credits or something, then maybe your
9 effective tax rate will be less than 35 percent. So
10 I'm not sure how you respond to the effective tax rate
11 other - to a request for an effective tax rate other
12 than by pretty much telling them how you want it done.

13 Q. In order to save time, let me propose that we will put
14 our request in writing to give you greater instructions
15 and submit that to Mr. Ingram with copies to the other
16 counsel.

17 CHAIRMAN GOSS:

18 Will you be able to do that by the end of the
19 hearing? Because we've indicated that data
20 requests are due within ten days following the
21 date of the hearing.

22 MR. WUETCHER:

23 Yes, sir. We'll try to have that prepared and
24 submitted to counsel before the end of today or,
25 if not today, the beginning of the hearing

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tomorrow, if it goes on that long.

CHAIRMAN GOSS:

All right.

Q. One question regarding the payments that Kentucky-American would make to the parent corporation in return for any benefit that it might have received as a result of the lower tax rates for the entire group. Are those payments made by Kentucky-American to the parent, are those required pursuant to the federal tax code?

A. Are they required pursuant to the federal tax code? They're required usually pursuant to either a tax allocation agreement, which is a contract between the companies, or by virtue of a policy, a group policy, that the - the tax code doesn't specifically control flows of cash within a consolidated group.

Q. Okay. Are you familiar with the Commission's decision in Case No. 2002-00317 in which the Commission approved the transfer of control of Kentucky-American from American Water Works Company to RWE?

A. I am not.

Q. Let me represent to you, and, if my representation is inaccurate, I'm sure your counsel will go ahead and correct the inaccuracy, but described one of the conditions to the Commission's approval of the transfer of control as being that there should be some type of

1 sharing of any savings that resulted from the proposed
2 transfer of control of Kentucky-American from American
3 Water Works Company to RWE, and that included, I
4 believe, as part of the transaction, the creation of an
5 American subsidiary called Thames Aqua US Holdings.
6 You're familiar with that company, sir?

7 A. I've heard of it.

8 Q. Okay. Let me go ahead and ask those questions of a
9 subsequent witness.

10 MR. WUETCHER:

11 I think that's all we have. Thank you.

12 CHAIRMAN GOSS:

13 All right. Mr. Ingram, do you have redirect?

14 MR. INGRAM:

15 I do, Your Honor, just a few.

16 REDIRECT EXAMINATION

17 BY MR. INGRAM:

18 Q. Mr. Warren, assuming reasonable regulatory regulation,
19 would you expect Kentucky-American, a public utility,
20 to consistently have taxable federal income?

21 A. Yes.

22 Q. Do you understand that Kentucky-American records on its
23 income statement its federal income tax liability at
24 the statutory rate of 35 percent?

25 A. Yes, I do.

- 1 Q. Is that normal and what you would expect to occur?
- 2 A. It is normal, yes.
- 3 Q. Now, if Kentucky-American's cost of service, as
4 developed by this Commission, includes, as an increment
5 thereof, a federal income tax payment or obligation
6 less than the recorded amount on its income statement,
7 do you have an opinion as to whether or not Kentucky-
8 American would be more likely or less likely to achieve
9 its authorized return on equity?
- 10 A. If everything else stays the same and revenues are
11 decreased, then the company is less likely to earn its
12 allowed rate of return.
- 13 Q. And I take it it is your opinion that it would be
14 inappropriate for this Commission to assess that cost
15 of service to Kentucky-American.
- 16 A. I'm sorry. Which cost of service are you referring to?
- 17 Q. An income tax effective rate.
- 18 A. Yes, I do.
- 19 Q. Is it likewise your opinion that the imposition of an
20 effective tax rate or some consolidated adjustment on
21 Kentucky-American transfers the benefit of a company
22 that participates in the filing of a federal return
23 that's not located in this jurisdiction to Kentucky-
24 American?
- 25 A. Yes. It actually moves the benefit to the customers of

1 Kentucky-American. So the company doesn't get anything
2 out of it, obviously. In fact, it's to the company's
3 detriment, but the tax benefit is extracted from the
4 entire group.

5 Q. And, if Kentucky is the only participant in filing the
6 federal income tax consolidated return that's located
7 in Kentucky, that movement of a benefit would be from a
8 non-Kentucky jurisdictional company to the Kentucky
9 ratepayers; would it not?

10 A. It would. Yes, it would.

11 MR. INGRAM:

12 That's all I have, Your Honor.

13 CHAIRMAN GOSS:

14 Thank you. Mr. Spenard, recross?

15 MR. SPENARD:

16 One moment, please.

17 CHAIRMAN GOSS:

18 While you're thinking, let me ask him a quick
19 question. This may have been answered. I'm not
20 sure.

21 EXAMINATION

22 BY CHAIRMAN GOSS:

23 Q. Do you know if any of American Water Works'
24 subsidiaries have been permitted to opt out of being
25 part of the consolidated tax return?

1 A. I'll give you the general rule. I don't know
2 specifically. The answer is no, but not because I have
3 particular knowledge of American Water Works companies.
4 The consolidated tax return rules are either everybody
5 that's eligible is in or nobody is in.

6 Q. All or nothing. Okay. That's fine. Thank you.

7 CHAIRMAN GOSS:

8 Go ahead.

9 RE CROSS EXAMINATION

10 BY MR. SPENARD:

11 Q. Mr. Warren, is it common for regulatory agencies to
12 make ratemaking adjustments to a utility's cost of
13 service?

14 A. When you say "ratemaking adjustments," I'm not quite
15 sure what you mean.

16 Q. Well, the utility makes a proposal to recover its
17 revenue and then the Commission would make an
18 adjustment and say, "No, this is not how we're going to
19 do this. We will make an adjustment and this is what
20 you're going to receive in your cost of service."

21 A. I have seen that before.

22 Q. Okay. As a result of these adjustments, do financial
23 statements for financial reporting purposes sometimes
24 differ in terms of recording revenues and expenses than
25 the utility's regulatory books?

1 A. Yes.

2 Q. Okay.

3 MR. SPENARD:

4 We have no further questions for Mr. Warren at

5 this time.

6 CHAIRMAN GOSS:

7 Okay. Thank you, Mr. Spenard. Mr. Childers, Mr.

8 Barberie, Mr. Ockerman, Mr. Wuetcher, anything

9 further?

10 MR. WUETCHER:

11 No, sir.

12 CHAIRMAN GOSS:

13 Anything further, Mr. Ingram?

14 MR. INGRAM:

15 No, Your Honor. May this witness be excused?

16 CHAIRMAN GOSS:

17 Yes, he may. Thank you, sir, very much. You

18 may step aside.

19 MR. WARREN:

20 Thank you, Your Honors.

21 CHAIRMAN GOSS:

22 Okay. Mr. Ingram, you can call your next witness.

23 MR. INGRAM:

24 Rich Svindland.

25

1 CHAIRMAN GOSS:

2 Mr. Svindland, please come down.

3 WITNESS SWORN

4 CHAIRMAN GOSS:

5 Anytime, Mr. Ingram.

6 The witness, RICHARD C. SVINDLAND, after having
7 been first duly sworn, testified as follows:

8 DIRECT EXAMINATION

9 BY MR. INGRAM:

10 Q. Would you state your name, please?

11 A. Richard C. Svindland.

12 Q. Do you work for Kentucky-American Water Company?

13 A. Yes, I do.

14 Q. In what capacity?

15 A. I've had a couple of different jobs with them. I'm
16 currently a Technical Services Manager for the
17 Southeast Region. I was a Senior Operations Engineer
18 and started with the company as an Operations Engineer
19 in 1999.

20 Q. From September 11, 2001 to date, have you been
21 instrumental in the efforts of Kentucky-American Water
22 Company to provide enhanced security for its
23 facilities?

24 A. Yes. Certainly, I guess, being an engineer and being
25 asked to look at different things for different parts

1 of our facilities, that's one of my main focus, is to
2 try to make sure we didn't put things in the wrong
3 place and make sure we had a plan going forward.

4 Q. Have you done that for other operating companies in the
5 American system other than Kentucky?

6 A. No, just Kentucky.

7 Q. Were you instrumental in preparing the federally
8 required vulnerability assessment for Kentucky-
9 American?

10 A. Yes. For the vulnerability assessment for Lexington, I
11 was part of a team that put that together. That was
12 the first go-around, but, personally, I did the
13 vulnerability assessment for the Tri-Village system or
14 the Northern Division that was due in this year.

15 Q. You have not filed testimony in this case; have you?

16 A. That's correct.

17 MR. INGRAM:

18 Your Honor, I brought Mr. Svindland because he
19 was the assigned person for some data responses
20 and I felt like yesterday there were a number of
21 questions regarding security that were
22 inappropriate for the two witnesses I had
23 yesterday. So, at this point, even though he
24 doesn't have any testimony, I'll be glad to
25 submit him for whatever examination may be

1 appropriate.

2 CHAIRMAN GOSS:

3 All right, Mr. Ingram. Thank you very much.

4 Mr. Spenard, do you have questions of this

5 witness?

6 MR. SPENARD:

7 No, sir, we do not have any questions for Mr.

8 Svindland.

9 CHAIRMAN GOSS:

10 Okay. Mr. Childers, Mr. Barberie, Mr. Ockerman,

11 any questions?

12 MR. OCKERMAN:

13 No, sir.

14 MR. BARBERIE:

15 No, sir.

16 CHAIRMAN GOSS:

17 All right. Mr. Wuetcher, do you have any

18 questions?

19 MR. WUETCHER:

20 Yes, sir.

21 CHAIRMAN GOSS:

22 Okay.

23

24

25

1 CROSS EXAMINATION

2 BY MR. WUETCHER:

3 Q. Good morning, sir.

4 A. Good morning.

5 Q. Let me start, in terms of security regarding Kentucky-
6 American's facilities, are you the person that's
7 responsible for security in terms of the planning or
8 overseeing security?

9 A. I wasn't the only one. Certainly, as an engineer, I
10 reported to, I guess, senior management, but I took a
11 lot of the burden on myself to get things done. A good
12 example is I was told to secure certain things. I
13 worked Saturday and Sunday till they were done.

14 Q. Okay. I'm just trying to get an idea of who does what
15 within the local company.

16 A. Okay.

17 Q. If there is a security issue, is that directed to you
18 and then farmed out to various people?

19 A. We've taken security very seriously. It's not just one
20 person. It's been a group of us. So . . .

21 Q. Well, that's what I'm trying - who coordinates
22 everything, then, at Kentucky-American for security?
23 Are you the coordinator?

24 A. In certain aspects, yes. I would say, right off, Nick
25 Rowe, who was our Vice-President of Operations at the

1 time, was the main person that put the team together.
2 From an implementation standpoint, I was the main
3 person that implemented most of the dollars that you
4 see here.

5 Q. Okay. Who else was on the team?

6 A. Donna Braxton was our Loss Control Director at that
7 time. We had people from Production, Distribution,
8 Water Quality, and then myself, Engineering.

9 Q. Was there one overall person responsible for security
10 prior to September 11th?

11 A. At that point - and I think Mr. Larson and Mr. Rubin
12 talked about it yesterday - security was more, you
13 know, an inside threat, vandalism, those issues, and
14 that fell under the direct responsibilities of the
15 Director of Loss Control.

16 Q. So that would be Ms. Braxton?

17 A. At that time, yes.

18 Q. To your knowledge, had assessments for vulnerability to
19 outside attacks been conducted prior to September 11th?

20 A. Kentucky-American had initiated a local consulting firm
21 to prepare a security plan for our facilities. We were
22 doing those before September 11th. A good result of
23 that was, you know, we all have card readers. We had
24 that before September 11th. Those things were being
25 implemented prior to September 11th.

1 Q. Who was the local consultant?
2 A. I believe the company was Mason & Hanger.
3 Q. And that consultant had produced a report indicating at
4 least some potential vulnerabilities prior to September
5 11th?
6 A. Correct, and it had to do with mostly securing our
7 facilities, you know, fencing improvements, card access
8 improvements; nothing in the magnitude of, you know,
9 intruders intentionally trying to destroy or interrupt
10 the water service.
11 Q. Do you know if, prior to September 11, 2001, Kentucky-
12 American had developed any contingency plans regarding
13 the protection of its facilities in terms of having
14 outside people come in, for example, either law
15 enforcement or the National Guard?
16 A. We have an emergency operations plan and that's, you
17 know, it's a fairly thick document, and you can't
18 forecast every scenario, but certainly there were
19 things in place in that; what we would do, who you
20 would call, contacts to make. A good example would be
21 the Lexington police, DEEM, which is a Lexington-
22 Fayette County for Emergency Management, hazardous
23 material, that kind of stuff.
24 Q. Okay, and that plan had been developed prior to
25 September 11th?

- 1 A. Yes.
- 2 Q. And did that plan make contingencies for the use of
3 non-Kentucky-American personnel for facilities
4 security?
- 5 A. I don't recall every part of that plan, but I think it
6 did.
- 7 Q. Prior to September 11, 2001, what contacts did
8 Kentucky-American have with local law enforcement or
9 Emergency Management personnel regarding security?
- 10 A. Like I said, that fell under the Director of Loss
11 Control. I did not have any knowledge of what contacts
12 were made, but I know, you know, as part of having
13 hazardous chemicals on the site, there are certain
14 regulatory requirements on who you have contacts with,
15 you know, the Lexington Fire Department, Lexington
16 police, DEEM. Those contacts had already been there.
- 17 Q. Okay. On September 10, 2001, who provided the physical
18 security at Kentucky-American's facilities?
- 19 A. At that point, we had one security guard, unarmed
20 guard, in the lobby. That was the only person on the
21 premises as far as outside security forces, and that
22 person - you know, there's money being transacted in
23 the lobby, because people are paying their bills. So
24 that was the main focus for that guard.
- 25 Q. Was that guard an employee of Kentucky-American or

1 outside services?

2 A. That was a guard provided by Murray Guard.

3 Q. And how long had that guard, that type of guard

4 service, been employed by Kentucky-American?

5 A. At least since my first day, which was October 1, '99.

6 I don't know before that. I wasn't there.

7 Q. Were you involved in the immediate planning after

8 September 11th?

9 A. Yes.

10 Q. Okay. Can you describe for us - immediately after the

11 attacks, I assume there was a decision made to request

12 the services of the Lexington Police Department?

13 A. Correct.

14 Q. Okay. Who made that decision, and can you describe for

15 us the rationale behind it?

16 A. Okay. Let me interject some of my parts in that real

17 quick, just so you have a feel.

18 Q. Okay.

19 A. Being an engineer and knowing how our plants operate,

20 and this is probably scary to some people, but I could

21 tell you three spots that you could take out everything

22 and there would be no water in Lexington. That scared

23 management, because they didn't realize, "Hey, we're

24 that susceptible," but most utilities are. Most places

25 have a center that you can do some serious damage. So

1 part of my duty was to inform folks of, "Hey, here's
2 our really weak spots. This is what we need to
3 protect." I gave that input to Donna Braxton and Nick
4 Rowe. They ultimately made the decision, "Okay, we
5 need to hire armed police guards to help secure those
6 areas." In some of the answers I prepared for the data
7 requests, you know, there's a third site that a police
8 officer is located. That was Lock and Dam No. 9. As
9 most people are aware, because of our source of supply
10 issue, that's a critical asset for our pool. That was
11 thought that we needed to protect that as well. So an
12 officer was sent there. From some conversations I had
13 with Herb Miller and Roy Mundy, they apparently had
14 approached the Governor about providing National Guard
15 folks or State Police to that dam, and the comment, and
16 this is just what I've been told, but the comment was,
17 "We're not going to alter our way of life. That's what
18 the terrorists want. We'll just go on as normal." We
19 didn't like that answer, to be honest with you. So we
20 stationed a Lexington officer at Lock and Dam No. 9,
21 which is not in Fayette-County. It's between Madison
22 County and Jessamine County, and I think Channel 36
23 even had some news stories about "Why is this guy
24 here?" but that was why he was there; he was trying to
25 protect that.

1 Q. Okay. Well, let me step back for a second.

2 A. Yeah.

3 Q. Then September 11th occurred, and I take it, at that

4 point in time, Kentucky-American contacted the local

5 Police Department and said, "We believe we need some

6 extra - we need some assistance in guarding some

7 critical assets at the plant"?

8 A. Correct.

9 Q. And those communications, I take it, were between

10 either Mr. Mundy and Mr. Rowe and who? The Mayor of

11 Lexington, or do you know who . . .

12 A. I don't know who they called directly to find that out.

13 Q. Okay. At the time that those services were being

14 provided, was there any discussion - I assume the

15 immediate concern was just the protection of the

16 facilities.

17 A. Correct.

18 Q. But, after, I assume, the personnel were in place, were

19 there discussions regarding the cost of the service and

20 how the arrangements were to be made in terms - was

21 there a written agreement between Kentucky-American and

22 Lexington?

23 A. No, not that I'm aware of.

24 Q. Okay. My understanding is that, for the first six

25 months, until sometime in March of 2002, the services

1 were being directly provided by Lexington-Fayette Urban
2 County Government.

3 A. That's correct.

4 Q. So how was that transacted in terms of the determina-
5 tion being made as to the number of personnel that were
6 needed and what the compensation was to be made to
7 Lexington-Fayette Urban County Government?

8 A. We had a direct contact, Sergeant Curtis, at the
9 Lexington police force. He was basically the person
10 that coordinated all the different Lexington police
11 officers that showed up. We were covering three sites,
12 24/7. We were paying - remember, these officers were
13 working their normal jobs and then working overtime to
14 cover our facilities. So we were paying time and a
15 half at their regular rate, just their salary. There
16 was no benefits, nothing included in that cost. We
17 just paid them that fee. They submitted an invoice to
18 us for those fees, and that's what we paid.

19 Q. Now, just so I'm clear on this, when you say they were
20 ordered there by Lexington-Fayette Urban County Govern-
21 ment in response to . . .

22 A. That's correct.

23 Q. They weren't in some way acting in a private capacity?

24 A. No. The City was providing the coverage for us. We
25 reimbursed them.

1 Q. You mentioned a request had been made to perhaps deploy
2 National Guardsmen. When was that request made, and do
3 you recall how soon you got a response from the State
4 officials?

5 A. I don't know the exact dates. I just was told, when
6 some of the questioning started yesterday did we ever
7 make contacts, and we found out, yes, we had. I guess
8 we could try to provide that information, but it was
9 between Herb Miller, Roy Mundy, and the Governor.

10 Q. The pay arrangements or compensation, did that include
11 any compensation for the use of City equipment or just
12 simply for the personnel?

13 A. We were paying straight salary. That was it.

14 Q. And the direct employment arrangement that ended at the
15 end of March of 2002, what led to the termination of
16 that arrangement?

17 A. My understanding is that the Lexington police came to
18 us and said, "We can't continue in this fashion because
19 you're not truly paying all the costs associated with
20 these officers." There's benefits. There's pension
21 plans. Ultimately, I mean, some of these folks are
22 making a pretty good bit of money. Vehicle use, all
23 those other costs weren't being covered. They said,
24 "You've got to take this on your own." So that's what
25 prompted the decision to go to Alliance, because

1 Alliance could hire all those officers as temporary
2 employees, issue W-2s for them, take care of all the
3 administrative, taxes, all those issues, and then pay
4 them. That way, Lexington wasn't having to worry about
5 some of their costs. So we were kind of forced to do
6 that. We didn't have any choice.

7 Q. Okay. Well, let me step back. You mentioned Alliance
8 Staffing. Who suggested the use of Alliance Staffing?

9 A. That was a relationship we had with the staffing
10 company. The decision was made to not broadcast this
11 so everybody knew what we were doing. We wanted to
12 keep it close to vest. So that was a firm that we had
13 used.

14 Q. And I take it, at the point that Alliance Staffing
15 entered in, the arrangement between Kentucky-American
16 and the police officers were somewhat different. They
17 were now reporting there as - they weren't actually on
18 duty with the Lexington Police Department anymore?

19 A. That's correct.

20 Q. And they weren't being sent there by the Lexington
21 Police Department?

22 A. That's correct.

23 Q. So all scheduling - these officers were now voluntarily
24 - they were voluntarily there? They were the same as
25 if they were moonlighting?

1 A. Correct. Now, my understanding is Sergeant Curtis
2 still actually performs some administrative duties in
3 procuring officers to come, but, yes, it was on a
4 volunteer basis who actually wanted to show up.

5 Q. Okay. You mentioned that Kentucky-American had a
6 previous relationship with Alliance Staffing. What was
7 that previous relationship?

8 A. Just temporary employment duties. It could be anything
9 from a clerk, you know. I'm not in Human Resources so
10 I don't know exactly what they used or all the
11 different positions they tried to use them for, but,
12 you know, you certainly have turnover in any business
13 and sometimes you want to bring in a temp just to fill
14 the void and that's what they were used for.

15 Q. Could the work of Alliance Staffing have been procured
16 through a competitive bidding process?

17 A. Yeah. I mean, it could have.

18 Q. Can I take it, as you mentioned before, it was because
19 of security concerns?

20 A. Right.

21 Q. Can you elaborate on that for me? I'm trying to
22 understand. As long as you have personnel out there
23 protecting the facilities, why was there a concern
24 about how you procured those personnel?

25 A. Well, I guess the way I look at it and the input I gave

1 into the process was that the more folks we know - or
2 the more companies that know how many officers we have,
3 where they are, all those things, there's a compromise
4 of some sort. Yes, you could enter into confidenci-
5 ality agreements potentially with different firms
6 you're trying to solicit from, but we didn't want to
7 take any chance at all. We had a relationship with
8 this person. We knew we were just telling one person.
9 That one person would know where the police officers
10 were. It wasn't broadcast everywhere.

11 Q. Do you know if there is anyone in a management position
12 or who has an ownership interest in Alliance Staffing
13 that's related or affiliated with persons employed by
14 Kentucky-American?

15 A. Not that I'm aware of.

16 Q. To the extent that Kentucky-American has used Alliance
17 Staffing, is Alliance Staffing required to file some
18 type of disclosure if they would have any persons that
19 would be related to individuals working for Kentucky-
20 American?

21 A. I don't know our exact policy on that matter. I do
22 know for other items we try to look into that and make
23 sure there's no issue. I don't know for that.

24 MR. INGRAM:

25 Mr. Wuetcher, if I can help here a little bit, it

1 is my understanding that there is no relationship
2 in any way, shape, or form with the owners of
3 Alliance and Kentucky-American. Alliance happened
4 to have been a, I think the right word is,
5 disadvantaged contractor that Kentucky-American
6 had previously used and there's no connection. If
7 you want to make that a data request that I can
8 confirm with Kentucky-American management, I'll be
9 glad to do that.

10 MR. WUETCHER:

11 Let me think about that. If Staff wishes to do
12 so, we'll add that to the other requests we're
13 getting ready to submit to you in writing.

14 MR. INGRAM:

15 Thank you.

16 Q. There appears to be a focus on the Lexington Police
17 Department in terms of the personnel that were hired.
18 Were any other police departments requested to provide
19 assistance?

20 A. No, just Lexington.

21 Q. Okay. Why was that?

22 A. Well, for the most part, they knew where most of our
23 facilities were.

24 Q. Okay. To the extent that you had facilities that were
25 outside of Fayette County, what about those facilities?

1 A. There were informal discussions with sheriffs of other
2 counties to say, "Hey, would you mind driving by this
3 tank site every once in awhile?" and that kind of
4 stuff. Our crews were doing that as well, but we were
5 not charged any of those fees to do that.

6 Q. After the direct arrangement ended, was there any
7 discussion about using a commercial security firm in
8 lieu of off-duty police officers?

9 A. Yeah. That discussion was actually going on throughout
10 this whole process. Management was trying to reduce
11 costs best they could, and I was kind of in charge of
12 implementing some of our security items, without
13 getting into too much detail, and it's easy to say you
14 put them in and make them work. Well, it wasn't that
15 easy to get them up and running. We had some
16 reliability issues. We had some false positives, those
17 type of things. I wasn't comfortable saying, "Hey, we
18 can get rid of the police officers and go to guards"
19 yet. There was a transition to make sure we felt
20 comfortable with what we had put in place.

21 Q. Okay. Let me step back on your response. What type of
22 analysis was being done at this time to say, "When can
23 we fit in commercial security guards?" and what type of
24 commercial security guards? We heard yesterday that
25 there was a difference between unarmed guards and armed

1 guards.

2 A. Part of this is, you know, we were waiting - well, I
3 shouldn't say waiting. That's not the right word, but
4 we were working on our vulnerability assessment, trying
5 to get the final guidelines from EPA so we weren't
6 going way off on a tangent, to make sure we were
7 looking at this properly. In doing that vulnerability
8 assessment, you know, we learned a lot about security
9 and how to look at different aspects of security. I
10 think they did talk yesterday about there's four areas;
11 there's delay, detection, response, and recovery, and,
12 when you have a list of a thousand assets that you're
13 trying to protect, you've got to go through each one of
14 those assets and try to figure out, okay, what's
15 driving this. I'll give you an example that's not, if
16 that's okay, but not pertinent to this, but let's say
17 Tri-Village relies on a master meter with Owenton to
18 get water. That is a critical asset for Tri-Village
19 because, without that master meter pit, there's no
20 water coming to their system. You could say, "Yes,
21 we'll put our armed guard there to watch it." That's
22 way overkill, because, in the end, even though we may
23 not detect any intrusion on that master meter pit, we
24 may not delay anybody, in the end, if they blew it up,
25 we know how to fix mains. We'd just put a main in the

1 ground and get that back and running. So we had to go
2 through that process for all the different aspects,
3 and, once we felt comfortable with where we were from a
4 delay, detection, response, and the response is where
5 the officers come into play because they also help on
6 the deterrents, which is not really out there, but,
7 when you see an armed police officer, more people are
8 deterred than if it's a Murray guard. So we had to
9 make sure our delay, detection was up and ready and
10 we're in that whole process from, you know, after
11 September 11th to the completion of the vulnerability
12 assessment, going through that exercise for all the
13 assets. Then we're able to, okay, now we know what we
14 need to improve upon to get better delay and better
15 detection. We started working to that regard, and
16 there were some issues, and then we were ultimately
17 able to say, "Okay, now we've got these things in
18 place, we can remove the police officers." That's kind
19 of a long-winded answer, but that's what was going on.
20 The one aspect of - real quick, the one aspect of that
21 is also there's recovery, and certainly, the example at
22 the meter pit, that's easy recovery. Some of the other
23 recoveries are a lot tougher, and we were trying to
24 come up with plans that how we would handle that, and
25 so a good example is Lock and Dam No. 9. We actually

1 have a plan in place what we will do, and, until we had
2 those issues addressed properly, we did not want to
3 remove the guard or the police officer from that
4 facility.

5 Q. Well, I'm still not following you and it may just be my
6 ignorance of physical security matters. To the extent
7 that you've now got an off-duty police officer, at what
8 point do you say an armed security guard, that may be a
9 retired police officer or retired military MP, or
10 whatever, that's being retained or hired through a
11 commercial security firm at a lower cost - and, again,
12 I assume you all were looking at costs so I'm making an
13 assumption it's a lower cost - but at what point was
14 that being factored in? I'm finding it hard to find
15 the difference as you go along with the police officers
16 were remaining for a period of a year and there were no
17 adequate substitutes and then, when the substitute did
18 come in, it was an unarmed security guard. So I'm just
19 trying to figure out your sense of analysis, the
20 company, in terms of analyzing the situation where the
21 threat dropped, and I believe yesterday and you stated
22 today that part of the reason the threat dropped was
23 because you had some physical or technological devices
24 that were also implemented that aided that, but, in
25 terms of having a person on the ground there, at what

1 point or what analysis did you do to say that at a
2 certain point you just drop down from an off-duty
3 police officer to an unarmed commercial security guard?
4 A. The goal was to get rid of the police officers as soon
5 as possible, and I don't think we looked at an interim
6 step, because the goal was we knew we had a vision of
7 what we wanted, where we wanted to get to, and we were
8 trying to get that as soon as possible. It took until
9 the completion of the VA and then the timing to
10 implement things and test them, which happened in
11 August. I don't think we wanted to ramp down - in
12 hindsight, it would have been easier to try to ramp
13 down, you know, and maybe look at that, but we had a
14 goal in mind on how to get there and we were pushing to
15 get to that goal and then the decision was made we
16 could get rid of those or change the type of guard.
17 Q. When Kentucky-American made the decision to switch to
18 commercial guard services, what type of investigation
19 or approach did you all use?
20 A. We pretty much went with Murray Guard because that's
21 who we had. We performed background checks on all the
22 employees. We interviewed them personally. We didn't,
23 you know, rely on just who Murray Guard wanted to
24 provide. We interviewed each of those guards
25 personally and made a decision which ones we wanted.

1 Q. Was there any competitive or any solicitation of other
2 firms conducted?

3 A. No, it was just Murray Guard.

4 Q. Why only Murray Guard?

5 A. The same - kind of the same reason as before on
6 Alliance. We didn't want to broadcast, "Yes, we're
7 looking for guard services. We need three to cover
8 this, three to cover that," or "two for this, two for
9 that." We just wanted to meet with one person and say,
10 "This is what we need," work out the price, and go with
11 them, and that way it minimized who else knew.

12 Q. Is Murray Guard located in Lexington?

13 A. I believe so, but I think they're a franchise. There's
14 different offices around. I don't know the exact
15 structure of their entire company.

16 Q. Who is primarily responsible for investigating the
17 various courses of action for Kentucky-American in
18 terms of physical security?

19 A. Can you repeat that? What are you meaning?

20 Q. Okay. At Kentucky-American, I assume there was one
21 person who was overall responsible for, I guess, at
22 least giving courses of action or options to local
23 management on what security steps to make. Were you
24 that person?

25 A. Yeah, for the most part. I mean, there'd be a couple

1 of things I'd have to get some help on, but, for the
2 most part, yes, I took that on.

3 Q. Okay. In regard to the vulnerability assessment, when
4 was it completed?

5 A. It was submitted - the deadline, I believe, was the
6 last day of March in 2003.

7 Q. And that's when it was completed?

8 A. Correct. You have to send it to EPA and have this
9 registered return receipt and all this stuff. They
10 have to verify that they got it. It's not something
11 you'd say, "It's in the mail." They have to make sure
12 they get it.

13 Q. And you mentioned that you were part of a team. Who
14 else was on the team?

15 A. Yes. You met Bruce Larson yesterday, and the other
16 person was Steve Schmitt.

17 Q. And who is Mr. Schmitt?

18 A. At that time, he was the Director for Security for
19 American Water based in Voorhees. He was Bruce's boss,
20 if you will.

21 Q. Do you have Kentucky-American's Response to the
22 Commission's Fourth Set of Information Requests,
23 Item 33? You're indicated as the person responsible
24 for preparing that Response.

25 A. Yes, I have that.

- 1 Q. Well, let me ask this question to you. I'm not certain
2 you're going to be able to respond to it. You may have
3 to refer it to someone else, but are the guard costs
4 referred to in your Response, the 228 hours per week,
5 represented by the monthly forecasted accrual of
6 \$11,201 per month for an annual total of \$134,412 to
7 Account 5711.16?
- 8 A. I know a little bit about that because I had to
9 inquire. The guard, the 228 hours a week, that's
10 correct, but we had previously 40 hours - we talked
11 earlier we already one guard on site. That was already
12 in rates. So really 188 hours is the additional for
13 this rate case. That \$11,000 approximately per month
14 is that cost for those 188 hours and that was in the
15 forecast period.
- 16 Q. Just so that we understand, the \$11,201 is just for the
17 additional 188 hours?
- 18 A. Correct.
- 19 Q. In your work now, now that you've become an expert in
20 the security area, have you had cause to talk to people
21 or your compatriots at the other American Water Works
22 operating companies regarding security issues?
- 23 A. Yeah, I've been able to travel to different states and
24 see different things.
- 25 Q. In terms of their acquisition or retention of

1 commercial security services, did any of those
2 companies use a competitive bidding process to secure
3 commercial security firms?
4 A. To be honest, I do not know. I didn't talk to them
5 about that part of it. I just looked at what they were
6 doing.
7 Q. Okay. Did you have any contact or guidance from
8 corporate headquarters regarding doing any type of
9 competitive bidding?
10 A. No.
11 Q. In your, I guess, examination of the literature and any
12 conferences that you may have attended that have been
13 put on by various federal agencies, has that come up as
14 an issue, the use of commercial security guards?
15 A. Yes, it's certainly been discussed.
16 Q. And in terms of - has there been any recommendations
17 made by those agencies, one way or the other, about the
18 method or manner in which you would solicit those
19 firms?
20 A. I don't recall any specific outcomes of any of those.
21 I would beg to offer that certainly there are companies
22 that are doing a competitive bid to get services. We
23 just chose not to because we thought we had further
24 protection.
25 Q. Just out of curiosity, did you check to see how the

1 federal government has procured its commercial services
2 security firms?
3 A. No.
4 Q. So, for example, if I told you that the security, at
5 least the initial security, around, say, some military
6 installations is being bid out by commercial contract,
7 that wouldn't - would that come as a surprise to you
8 or . . .
9 A. Not necessarily. We're, as a water utility, bidding on
10 the operations of water assets at military bases, so it
11 wouldn't be a surprise.
12 Q. Okay. One final question, and that concerns your
13 Response to the Item 33 in the Commission Staff's
14 Fourth Set of Information Requests . . .
15 A. Okay.
16 Q. The amount that includes the 40 hours per week, do you
17 know what account number that amount is charged to?
18 A. I could find that. When I was doing all these costs,
19 that's how I figured out it went to a different
20 account. So . . .
21 Q. Could you provide us with that information, just which
22 account number it is?
23 A. Yeah.
24 MR. WUETCHER:
25 That's all we have. Thank you.

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CHAIRMAN GOSS:

Does the Commission have any questions?

COMMISSIONER COKER:

I have one.

EXAMINATION

BY COMMISSIONER COKER:

Q. When Alliance Staffing was utilized, did the security guards continue to drive police cruisers and/or have access to any other police equipment, i.e., radios?

A. Yes. They were exact - to the public, no one would have noticed the difference. They still showed up in their vehicles. They still had uniforms, still had guns. The public wouldn't have noticed any difference between using Lexington direct and Alliance.

Q. So they still had access to police radios and the cruisers?

A. Correct, and, as a matter of fact, a lot of times, you know, just leaving at night, talking to the officer, he said, "Yeah, I got three speeders already going by." So, I mean, they were still doing some duties even though they were sitting there watching our facilities.

Q. Thank you.

EXAMINATION

1
2 BY CHAIRMAN GOSS:

3 Q. Did you deal with Jackie Howard, the President of
4 Alliance Staffing, at the time that the transition was
5 made from dealing with LFUCG directly for their off-
6 duty officers and when Alliance came on board?

7 A. I personally have not dealt with her.

8 Q. Who dealt with her?

9 A. Donna Braxton would have been the person that worked
10 with her.

11 Q. Were you familiar, at least on sort of a secondhand
12 basis, with the overhead amounts that Alliance was
13 expecting?

14 A. Yes, that was discussed, I mean, because we realized we
15 were going from a certain rate up to another rate and
16 we had to, "Does that make sense?" and we ran those
17 numbers.

18 Q. Well, let me tell you what concerns me about this. In
19 Dr. Rubin's testimony . . .

20 CHAIRMAN GOSS:

21 Could he be provided with Dr. Rubin's . . .

22 A. I've got a copy of it.

23 Q. Okay. Turn to Page 15.

24 A. Yes.

25 Q. At about Line 15, he indicates that initially Kentucky-

1 American was paying overtime to the City of Lexington
2 police officers at roughly, we'll call it, \$27 an hour.
3 Do you see that?
4 A. That's correct.
5 Q. And do you agree generally with that figure?
6 A. Yes, I helped derive that number for Dr. Rubin.
7 Q. Okay. All right. And then - of course, that was at
8 the time that Kentucky-American was dealing directly
9 with LFUCG for these officers; is that right?
10 A. That's correct.
11 Q. Then over on the next page, on Page 16, beginning at
12 the top of the page, he indicates that, when Alliance
13 was contacted and the transition was made to Alliance,
14 that these officers were paid approximately \$51 an
15 hour. Do you see that on Line 5?
16 A. Yes. I wouldn't say that the officers were paid \$51 an
17 hour. I would say that's what Alliance was paid.
18 Q. No, that's correct. Alliance was paid \$51 an hour;
19 correct?
20 A. Yes.
21 Q. All right, and you agree with that amount generally?
22 A. Correct, yes.
23 Q. There on Line 5, Dr. Rubin says that, "According to
24 Jackie Howard, the President of Alliance Staffing, 65-
25 70 percent overhead for temporary W-2 employees is

1 common in the industry and covers the cost of
2 scheduling, management, liability insurance, statutory
3 benefits, and a 10-15 percent profit." Do you see
4 that?

5 A. Yes.

6 Q. There's a footnote there that says that that was as a
7 result of a personal communication that Dr. Rubin
8 apparently had with Jackie Howard on April 8th of this
9 year.

10 A. Yes. I was in the conference room during that call.

11 Q. Okay. Well, I'm not the best mathematician in the
12 world, but, if you take \$27 an hour and you compare it
13 to \$51 an hour, that's almost a 100 percent increase,
14 just shy of 100 percent. As a matter of fact, I think
15 I calculated it yesterday and it's a 95 percent
16 increase. Assuming my math is right, can you explain
17 to the Commission why, if Alliance Staffing's overhead
18 was 65 to 70 percent and that included their profit,
19 why the ultimate hourly rate that Kentucky-American was
20 paying Alliance was, in fact, 95 percent of what it was
21 before?

22 A. My understanding and . . .

23 Q. I'm sorry. Not 95 percent of what it was paying
24 before, a 95 percent increase over what it was paying
25 before.

- 1 A. Right. Right. My understanding is that Jackie Howard
2 negotiated a price to pay the Lexington police
3 officers. Remember, they had a huge range of salaries
4 and we were paying just the one and a half times
5 whatever their salary was. She had a price that she
6 was paying the police officers, I believe, of \$30 an
7 hour. That was a fixed cost, so it didn't matter who
8 she got; she paid them \$30 an hour, and you take the
9 \$30 and multiply it by 1.7 and you're at \$51. I think
10 that's as simple as the math came out to be.
- 11 Q. Well, do you see where I'm going?
- 12 A. Yes.
- 13 Q. I mean, do you understand my quandry? So you can't
14 really - I mean, you just don't know or you can't
15 explain the difference in the 65 to 70 percent overhead
16 and the 95 percent? I mean, do you have any
17 explanation for that?
- 18 A. If Ms. Howard paid the officers \$30 an hour and you
19 multiply it by 1.7, that's \$51, and that would include
20 all the overhead costs with a 10 to 15 percent profit.
- 21 Q. Tell me again the 1.7 factor. What is the 1.7 factor
22 that you're using?
- 23 A. That was the high end of the 65 to 70 percent. I just
24 used 1.7.
- 25 Q. All right. Dr. Rubin continues on Line 8, and he says,

1 "Without a full audit of actual costs, I am unable to
2 speculate as to the reasonableness of these overhead
3 charges from Alliance, although in the professional
4 services industry, of which consulting is a part, this
5 level of overhead is considered reasonable." Do you
6 agree that that level of overhead is reasonable in the
7 industry?

8 A. Yeah. From my prior - I was a consultant before I came
9 to Kentucky-American and, when we allocated costs, we
10 usually used a 50 percent markup for benefits, you
11 know, FICA, all those different items. So you're at 50
12 pretty easy and then, when you add the 10 to 15 percent
13 profit, and then the other thing that she had included
14 was her cost of liability coverage. You know, she went
15 from being a temporary agency that staffed secretaries
16 to now staffing armed police guards. There's certainly
17 a difference in liability that she was seeing that she
18 had to cover.

19 Q. All right, and tell me again why it took Kentucky-
20 American 16 months, between April of '02 and August of
21 '03, to decide that it should go to a private guard
22 entity?

23 A. The main driver was completing the vulnerability
24 assessment. EPA guidelines on how to do that document
25 weren't available to us until January of '03. So we

1 were in kind of a wait and see mode as to exactly how
2 we would finalize our vulnerability assessment. Once
3 we had that, we knew - the vulnerability assessment
4 helps us determine what's reasonable; what's too much,
5 what's not enough. That was the main tool that we had
6 to get done. So, from January of 2003, we got the
7 guidelines. We finished that report in a two-month
8 period. Then, from March of '03 to August of '03,
9 that's really the timeline we had to try to make this
10 transition. I was being pushed to try to get it done
11 faster. I just didn't have any confidence in some of
12 the equipment we were putting in to make sure we could
13 do that, and that was my pushback to say, "Hey, folks,"
14 you know. A good example, we put in one system and,
15 the first day we put it in, we had a thousand hits of
16 false alarms. Well, that's not going to work. I mean,
17 who's going to watch that? So we had to work the bugs
18 out of those systems before we could make the
19 transition. You know, my opinion is we did it pretty
20 well.

21 Q. And when do you think that you got your infrastructure
22 in place to your satisfaction? Was it not until August
23 of '03, or was it some weeks or months before that?

24 A. It all kind of culminated at that time. August '03, we
25 had some of our facilities, the plants and tank sites,

1 those things were where we wanted them to be and also
2 we had a consultant working on some issues on Lock and
3 Dam No. 9. All these things kind of came right at that
4 time and we were able to make the decision. We had all
5 the pieces to make the decision.

6 Q. All right, and give me an idea of the size of Alliance
7 Staffing. I mean, is it basically one lady with a
8 couple of telephones and a rented office somewhere, or
9 is it a bigger operation than that?

10 A. I believe it's somewhere in that size. It's one owner
11 with a couple of helpers, maybe full-time employees. I
12 don't know the exact extent of her operation.

13 Q. Do you know if Alliance Staffing had provided LFUCG
14 officers to any other company or entity in the Central
15 Kentucky area that needed security?

16 A. I was never told of that. I would not know the answer
17 to that.

18 CHAIRMAN GOSS:

19 All right. That's all I have.

20 EXAMINATION

21 BY COMMISSIONER COKER:

22 Q. Is Kentucky-American Water the only client of Alliance
23 Staffing?

24 A. I wouldn't think so. I don't know for sure.

25 Q. What is Jackie Howard's previous background, the

1 temporary service you had mentioned?

2 A. I don't know her. I just know that's the person we
3 used.

4 Q. Thank you.

5 EXAMINATION

6 BY VICE CHAIRWOMAN WILLIAMS:

7 Q. I have one quick point of clarification. When you used
8 LFUCG police and then you went to Alliance Staffing and
9 then Murray Guard, were all those entities providing
10 security seven days a week, 24 hours a day?

11 A. The first two, yes. The Murray Guard, we were able to
12 drop it down a notch because of other things.

13 Q. Is that based on the vulnerability assessment?

14 A. Yes, that's correct.

15 CHAIRMAN GOSS:

16 Okay. I think those are all the questions that
17 the Commission has. Before we turn it back to Mr.
18 Ingram for redirect, why don't we take about a
19 15-minute break so we can stretch our legs and go
20 to the restroom and we'll come back at five
21 minutes till.

22 OFF THE RECORD

23 CHAIRMAN GOSS:

24 Everyone, please be seated. Thank you. Okay.
25 Mr. Ingram, we were about to turn it over to you

1 for redirect.

2 MR. INGRAM:

3 Very few questions, Your Honor.

4 REDIRECT EXAMINATION

5 BY MR. INGRAM:

6 Q. Mr. Svindland, in your work with Steve Schmitt as one
7 of the group of people who implemented the capital
8 expenditure programs of Kentucky-American directed
9 towards security, did he bring to the table expertise
10 acquired from Thames Water and RWE?

11 A. Yes, he did. We actually had a lot of PowerPoint
12 presentations back and forth what they did and what we
13 could be doing or kind of experiences.

14 Q. From 9-11-01 until Kentucky-American went to the
15 exclusive use of Murray guards, do you have any idea of
16 the total of the capital expenditures for security
17 alone?

18 A. You mean capitalwise?

19 Q. Capitalwise; yes, capital.

20 A. Probably around a million dollars.

21 Q. If a reasonable hourly rate is \$30 an hour, is it your
22 understanding and your testimony that a reasonable
23 number to add to that for all benefits would be 50 per-
24 cent of that number?

25 A. Yes.

1 Q. That would get us to \$45 as an effective rate per hour;
2 would it not?
3 A. Yes.
4 Q. And if you added 15 percent profit on top of a \$45 an
5 hour rate, that would get you to \$51.75 an hour;
6 wouldn't it?
7 A. You'd be right there, yeah.
8 Q. Thank you.
9 MR. INGRAM:
10 That's all I have.
11 CHAIRMAN GOSS:
12 Thank you, Mr. Ingram. Mr. Spenard?
13 MR. SPENARD:
14 No questions.
15 CHAIRMAN GOSS:
16 Mr. Childers, Mr. Ockerman, Mr. Barberie?
17 MR. BARBERIE:
18 No, sir.
19 MR. OCKERMAN:
20 No, sir.
21 CHAIRMAN GOSS:
22 Mr. Wuetcher?
23 MR. WUETCHER:
24 Just a couple, Your Honor.
25

1 RE CROSS EXAMINATION

2 BY MR. WUETCHER:

3 Q. In the course of your work in preparing the
4 vulnerability assessment and doing the other necessary,
5 or at least making the changes to improve security,
6 were you providing reports to the local management in
7 terms of the costs that were being accrued for this
8 extra security?

9 A. We have a program where we monitor capital spending.
10 You know, those dollars were being monitored just like
11 they do with any other capital project. As far as the
12 costs per the guards . . .

13 Q. Yes.

14 A. . . . I was not providing those numbers, but Donna
15 Braxton was. I mean, we knew what we were spending;
16 yes.

17 Q. Okay. So the top local management was aware that these
18 expenses were being accrued and were aware of it?

19 A. Yes.

20 Q. And what about the management at the next level?

21 A. I'm fairly confident that all upper management at
22 American Water in Voorhees knew what the costs were,
23 and this was all around the country, too. This wasn't
24 just Kentucky.

25 Q. Okay. So, to the extent that, if I were an official

1 with American Water Works or with Kentucky-American, I
2 would have a general idea of what the security costs
3 had been, say, in February of 2003?

4 A. Yes.

5 Q. And that these costs were being expended?

6 A. I'd say that's correct.

7 Q. And that these costs might still be - were still going
8 to incur them for some time as we make adjustments to
9 the new security environment?

10 A. Yes.

11 Q. Do you know if Alliance Staffing had any previous
12 experience with the police staffing?

13 A. I don't know the answer to that question.

14 Q. Okay. In the course of improving security for
15 Kentucky-American's physical facilities, did you have
16 an opportunity to talk to or consult with other local
17 utilities to see what they were doing?

18 A. We did not look at other local utilities. To be honest
19 with you, some of them weren't doing anything, which we
20 didn't think was the right approach. We looked at
21 other American Water facilities to make sure we were
22 doing things consistent.

23 Q. There weren't any discussions, for example, let's say,
24 with Kentucky Utilities or Louisville Gas and Electric
25 Company regarding what they were doing in terms of

1 arrangements for enhanced security at their facilities?
2 A. No, I did not have any contact with those folks.
3 Q. All right, and one final question, in terms of threat
4 assessment, during this period, did Kentucky-American
5 receive any specific threats regarding its facilities?
6 A. I've heard some discussion on that. I personally was
7 not aware of any threats towards Kentucky-American's
8 assets.
9 Q. Would you have been one of the people alerted had there
10 been a threat or if law enforcement had identified a
11 threat and communicated it to Kentucky-American?
12 A. I don't know that answer for sure. I guess it would
13 have depended on what the threat was, if they thought
14 they should get me to help evaluate how we were
15 prepared for that threat.
16 Q. Okay. Thank you.
17 CHAIRMAN GOSS:
18 Anything further from any attorney? Okay. You
19 may step down. Thank you, sir.
20 MR. SVINDLAND:
21 Thank you.
22 CHAIRMAN GOSS:
23 Okay. Mr. Ingram, call your next witness.
24 MR. INGRAM:
25 I call Linda Bridwell.

1 WITNESS SWORN

2 CHAIRMAN GOSS:

3 Mr. Ingram, anytime.

4 The witness, LINDA C. BRIDWELL, after having been first
5 duly sworn, testified as follows:

6 DIRECT EXAMINATION

7 BY MR. INGRAM:

8 Q. Would you state your name, please?

9 A. Linda C. Bridwell.

10 Q. You've testified before this Commission before, I
11 believe, Ms. Bridwell.

12 A. A few times, yes, sir.

13 Q. You do work for Kentucky-American Water Company?

14 A. Yes, sir.

15 Q. Is your office in Lexington, Kentucky?

16 A. Yes, sir.

17 Q. Have you filed direct and rebuttal testimony in this
18 case?

19 A. Yes, sir.

20 Q. If I asked you the questions contained therein today,
21 would you give me the same answers?

22 A. Yes, with three exceptions.

23 Q. What are they?

24 A. One in my direct testimony, I referred to my position
25 as the Director of Engineering at Kentucky-American. I

1 since have taken a position as the Project Delivery and
2 Developer Services Manager for the Southeast Region
3 which includes Kentucky. I also stated in my direct
4 testimony that I was Vice-President of the American
5 Society of Civil Engineers of Kentucky. I've since
6 been elected President. And, thirdly, in my direct
7 testimony, I talk about the Leestown Road Project
8 02-01, that it will be complete in 2004. Because of
9 some changes in relocation projects and lack of growth
10 in the Midway Industrial Park, we have shifted that
11 project back. So the capital expenditures have not
12 changed in the capital expenditures within the
13 forecasted test year, but that project has moved.

14 Q. With those three exceptions, you would give me the same
15 answers if I asked you the questions today?

16 A. Yes.

17 MR. INGRAM:

18 That's all I have at this time, Your Honor.

19 CHAIRMAN GOSS:

20 Thank you, Mr. Ingram. Mr. Spenard?

21 MR. SPENARD:

22 Yes, sir.
23
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25

CROSS EXAMINATION

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25

BY MR. SPENARD:

Q. Good morning.

A. Good morning.

Q. So you now have a new title.

A. Yes.

Q. Will you be providing services to other jurisdictions?

A. Yes.

Q. Okay, but you're still an employee of the Kentucky-American Water Company?

A. No. I'm now an employee of the Southeast Region.

Q. Okay.

A. My responsibilities include Kentucky, Tennessee, and West Virginia.

Q. Okay, and do these responsibilities include - these responsibilities would include regulated water?

A. Yes.

Q. Also any non-regulated activities?

A. It could. It hasn't to date yet.

Q. Okay. What about sewerage?

A. Yes.

Q. Okay. In what capacity do you have any responsibility for Rockwell Village Sewer?

A. Only for the capital expenditures of the Rockwell Village, and I'm generally familiar with the

1 operations, but I'm not familiar with the day-to-day or
2 responsible for them.

3 Q. Okay. In terms of engineering support for Rockwell
4 Village, who supplies that?

5 A. That would be in-house. That would be me and the
6 engineering staff at Kentucky-American.

7 Q. Okay. Do you oversee that?

8 A. Yes.

9 Q. Okay. Do you have any responsibility for services
10 provided to the City of Pineville?

11 A. I do not personally. There have been some engineering
12 services that I have directed that have been working
13 with the City of Pineville.

14 Q. Okay, and you're directing those, but who, aside from
15 your direction of those, who is providing the engineer-
16 ing support for the City of Pineville?

17 A. It has occasionally been an employee, Derrick
18 Churchill, who is no longer with us, and Rich
19 Svindland.

20 Q. Okay. Do you have any responsibility for services
21 provided to Bluegrass Station Division?

22 A. Again, I oversee the engineering services.

23 Q. And are the engineering support provided in-house?

24 A. Yes, and that has been me personally as well as Greg
25 Tomko and Rich Svindland.

1 Q. Okay. With regard to the Advisory Services Agreement
2 with the City of Jackson, can you summarize your role?
3 A. Again, I would be responsible for providing engineering
4 services. To date, I'm not aware of any engineering
5 services that have been provided to the City of
6 Jackson.
7 Q. Okay. Are you involved in any way in providing leak
8 detection services to other entities?
9 A. Only that I'm familiar with the contract with the
10 Kentucky River Authority and work with the Network and
11 Maintenance Department that provides those.
12 Q. Do those individuals report to you?
13 A. No, not directly.
14 Q. Okay, but, in terms of the line of responsibility,
15 ultimately, is that your responsibility?
16 A. No. They would report to the Network Supervisor and
17 the Network Superintendent and then to the General
18 Manager. Because of my familiarity with the Kentucky
19 River Authority and the other entities within the
20 basin, I've been involved in that contract.
21 Q. Okay. With regard to contracts in general, for a
22 number of years you've been involved with source of
23 supply; is that correct?
24 A. I believe I've made a career out of source of supply;
25 yes.

- 1 Q. Okay. So, if Kentucky-American were to begin
2 discussions with another entity regarding the provision
3 of water to the other entities, you would be involved
4 in those discussions?
- 5 A. Absolutely.
- 6 Q. And, with your new job title, you will remain involved
7 in those discussions?
- 8 A. Yes. That was a part of the terms of that change, was
9 that I would continue to be involved as a source of
10 supply for Kentucky.
- 11 Q. Okay. Kentucky-American - well, you started several
12 years ago. Kentucky-American was providing regulated
13 water service and that was basically all Kentucky-
14 American did, say, 1990-91?
- 15 A. Yes.
- 16 Q. Okay, and then, after the acquisition of the assets of
17 the Boonesboro Water Association, Kentucky-American got
18 in the sewerage business?
- 19 A. Yes.
- 20 Q. Okay, and then, subsequent to that or at some stage
21 along the way, Kentucky-American began providing other
22 services such as leak detection and O&M and other
23 management?
- 24 A. I believe so, yes.
- 25 Q. Okay, but the notion is, with regard to those non-

1 regulated activities, it's all within the Kentucky-
2 American water family of financial activity?
3 A. Yes.
4 Q. Okay. There has been a discussion - I'll withdraw
5 that. I'll move on to another subject. You were on
6 the Kentucky Infrastructure Authority?
7 A. I have just been appointed to it; yes.
8 Q. Okay, and, recently, there was a resolution concerning
9 a loan to the City of Owenton. Are you aware of that?
10 A. Yes, sir, I was at the meeting in October.
11 Q. Okay, and you refrained from voting on that?
12 A. Yes, I abstained from voting on that.
13 Q. Okay. Good. Good. So that's clear, but, aside from
14 that, the Infrastructure Authority is going to provide
15 some money so an intake can be purchased; is that
16 correct?
17 A. Yes, that's true.
18 Q. Okay. Now, Kentucky-American is currently in the
19 process of - I don't know if you all have scheduled a
20 closing, but the Owenton issue, you all want to take
21 over Owenton, basically?
22 A. We have a contract to purchase those City of Owenton
23 assets.
24 Q. Right, but you've yet to close?
25 A. That's correct.

1 Q. Okay. When you close, will that intake - is that
2 intake part of the deal, or will the City continue to -
3 who is going to have control of that intake?

4 A. I need to check with Mr. Bush, but it's my understand-
5 ing that the Owenton - the City of Owenton will still
6 own the intake and that we will lease the intake from
7 them.

8 Q. Okay. I want to just ask you a question - what
9 percentage of American Water Works' customers are
10 located in Pennsylvania, West Virginia, New Jersey, or
11 Texas?

12 A. I have no idea.

13 Q. Could you provide that for us just for the year, for
14 the current?

15 MR. INGRAM:

16 Well, the answer can we do it, yes, but that
17 assumes there's some relevance to the question.
18 If you can help me with the relevance of the
19 question, I'll be more specific about whether
20 or not we will provide the information.

21 MR. SPENARD:

22 Well, is that an objection, I guess, is the
23 question.

24 MR. INGRAM:

25 No. It's a refusal to supply the information

1 unless you can tell me the relevance of the
2 request.

3 CHAIRMAN GOSS:

4 I guess I'd prefer if you gentlemen, rather than
5 addressing each other, would talk to the
6 Commission about it.

7 MR. SPENARD:

8 Oh, I'm sorry. Yes, sir.

9 CHAIRMAN GOSS:

10 So we're going to treat it as an objection. Why
11 don't you state the relevance of it.

12 MR. SPENARD:

13 Well, we have a tax adjustment that we're
14 proposing and there was a question regarding
15 the states and the jurisdiction where Kentucky-
16 American operates as well as the status of the
17 treatment of that adjustment in those various
18 jurisdictions. The number of customers is
19 relevant to show the impact of those particular
20 jurisdictions and how they treat it. We have
21 50 states, 50 jurisdictions, and you can say,
22 well, in all these different jurisdictions, they
23 do it one way or the other. If they were
24 operating in all those jurisdictions, well,
25 that's fine, but, if we're going to go and start

1 showing where these customers are actually
2 located and the significance and importance of
3 the fact that this particular jurisdiction treats
4 it X way, it does tend to show the magnitude of
5 the impact that adjustment is going to have and
6 what's actually happening in the company. This is
7 a question of, if you say, X many people do it
8 this way, well, that's fine, but let's talk about
9 how the ones where you're located do it and how
10 this is going to impact your overall customer
11 base and ultimately how that's going to impact
12 Kentucky-American.

13 CHAIRMAN GOSS:

14 I'm trying to understand how that's relevant to
15 how it's treated in Kentucky. I mean, if it's
16 treated one way in Pennsylvania or one way in
17 West Virginia, what's the significance to
18 Kentucky ratepayers?

19 MR. SPENARD:

20 What we have seen, and we've seen it some in this
21 case, for example, with the testimony of Coleman
22 Bush, is that we'll ask a question and say, "Well,
23 we ought to do it this way or that way," and
24 they'll come back and say, "Well, look how we do
25 it in Pennsylvania." With regard to the security

1 costs and deferred assets, the deferral of these
2 assets, we had Orders from jurisdictions in
3 Missouri as well as two other jurisdictions.
4 Kentucky-American, they come to town and they say,
5 "This is the American way. This is how American
6 does it," or, "This is how RWE does it." Well,
7 this is just a legitimate inquiry to say, well,
8 let's look at how this works when it goes in
9 favor of the consumer. So it's not unusual for
10 Kentucky-American to point to other jurisdictions.

11 CHAIRMAN GOSS:

12 Okay. So you're merely asking that Kentucky-
13 American provide, by way of a data request, the
14 percentage or the pro rata distribution of
15 customers in the states that you mentioned versus
16 the whole? Is that what you're asking?

17 MR. SPENARD:

18 Well, that would be part of it. I mean, it's
19 just basically in what states do you operate,
20 how many customers do you have there, and it's
21 not confidential information.

22 CHAIRMAN GOSS:

23 I wouldn't think it would be confidential. Maybe
24 it is, but I'm sure, if it is, Mr. Ingram will
25 tell us. What else are you seeking, then, Mr.

1 Spenard, besides that basic information?
2 MR. SPENARD:
3 Basically, Mr. Chairman, that's it.
4 CHAIRMAN GOSS:
5 Okay. Mr. Ingram?
6 MR. INGRAM:
7 I don't think that it is at all relevant to the
8 impact of a consolidated tax adjustment on
9 Kentucky-American's customers to know how many
10 customers American Water Works has in Texas or
11 any other state, Your Honor.
12 CHAIRMAN GOSS:
13 Well, let me ask you this. Do you take the
14 position that that information, if the Commission
15 were to require Kentucky-American to provide it,
16 is in any way confidential or proprietary?
17 MR. INGRAM:
18 No, sir.
19 CHAIRMAN GOSS:
20 Okay. Mr. Wuetcher, do you want to weigh in on
21 this? Do you have a position one way or the
22 other?
23 MR. WUETCHER:
24 Not really, Your Honor.
25

1 CHAIRMAN GOSS:

2 Okay.

3 MR. WUETCHER:

4 Although I would say I tend to agree with the
5 company to the extent that the number of customers
6 may not have that great of a relevance as the
7 issue is more one of policy and, based on my
8 experience with the Commission when the Commission
9 has previously asked for how other states have
10 handled the issue, it is primarily looking at that
11 in terms to get a full understanding of the policy
12 arguments that the other commissions have
13 considered before they've rendered their decision.
14 While I can understand Mr. Spenard's assertion
15 that a state that may take a certain approach may
16 have only a limited number of customers involved
17 so it may not have as much of an impact as another
18 state which has a larger number of customers, but,
19 in terms of the review of the issue itself, I'm
20 not sure that the relevance is that great.

21 CHAIRMAN GOSS:

22 All right. Any of the other parties have a
23 comment to make? Mr. Childers?

24 MR. CHILDERS:

25 Yes, Your Honor. I believe I would join in Mr.

1 Spenard's request. I think this information
2 might be relevant to the low-income discount
3 program being proposed in terms of the other
4 programs in the other states and size of the
5 customer base in those states relative to the
6 size of the discount programs in those states.

7 CHAIRMAN GOSS:

8 Well, I guess I have some concern about the
9 relevance of it. However, if it's not pro-
10 prietary or confidential information, let's go
11 ahead - I would ask Kentucky-American to provide
12 it and, if Mr. Spenard wants to argue whatever
13 he wants to argue in his brief, he's certainly
14 entitled to, and the Commission will provide
15 whatever weight to that information that it's
16 entitled to.

17 MR. INGRAM:

18 It will be done, Your Honor.

19 CHAIRMAN GOSS:

20 Okay. Thank you, Mr. Ingram. Okay. Go ahead
21 and proceed.

22 MR. SPENARD:

23 With that, we have no further questions.

24 CHAIRMAN GOSS:

25 All right. Mr. Barberie?

1 MR. BARBERIE:

2 I have a few, but I don't know whether the
3 others . . .

4 CHAIRMAN GOSS:

5 Mr. Childers, do you have any questions?

6 MR. CHILDERS:

7 No questions.

8 CHAIRMAN GOSS:

9 Mr. Ockerman, will you have some?

10 MR. OCKERMAN:

11 Yes, sir.

12 CHAIRMAN GOSS:

13 Okay. Let's let Mr. Barberie go first.

14 CROSS EXAMINATION

15 BY MR. BARBERIE:

16 Q. Good morning, Ms. Bridwell. How are you this morning?

17 A. Good morning. Fine, thank you.

18 Q. When did you take your new position as Product Delivery
19 Manager for the, I guess, Southeast Region? Is that
20 one way of stating it?

21 A. Yes. I accepted the position in July. I don't recall
22 the exact date of when the transfer was made.

23 Q. Do you have an understanding - are you still serving, I
24 guess, as the Director of Engineering also?

25 A. In some regards. Some of my duties have changed.

1 Q. What is your understanding of the company's position
2 with respect to the Director of Engineering position?
3 Is it supposed to be that you are serving in both
4 capacities?
5 A. No. My responsibilities are shifting somewhat. The
6 Director of Engineering was responsible for all
7 engineering at Kentucky-American, period, and we are
8 working now so that some of the engineering functions
9 at Kentucky-American is done by other folks in the
10 region. I'm still responsible for the Project Delivery
11 and Construction Management.
12 Q. Well, I guess my real question is, is it your under-
13 standing that you're basically going to serve, continue
14 to serve, in the capacity as Director of Engineering or
15 is it your understanding they're going to hire somebody
16 that would basically do that?
17 A. It is my understanding that they're not hiring a
18 Director of Engineering, but most of the job function
19 will continue to stay with me.
20 Q. Okay. Currently, since July, since you've been in this
21 position, what has been your practical allocation
22 between the different regions?
23 A. Well, quite frankly, because of all the issues going on
24 with Kentucky-American, most of my allocation has
25 continued to be with Kentucky-American. I have charged

1 some time on some projects in Tennessee.

2 Q. Is there somebody better to ask as far as what the
3 intent on the allocation in the future would be than
4 yourself?

5 A. Well, I think it will just - I mean, I will continue to
6 be responsible for Kentucky and, as projects arise in
7 Tennessee and West Virginia, I will need to allocate
8 time for their direction as well. They have engineer-
9 ing staff there as well. I'm just now also directing
10 their construction.

11 Q. Is it your testimony that the base year will not be an
12 accurate reflection necessarily of what the future
13 allocation of your time would be among the regions?

14 A. No, that's not correct.

15 Q. Okay. Could you give me an estimate of what your
16 practical allocation would be among the different . . .

17 A. Well, the allocation of my labor as Director of
18 Engineering in the base year is my full - it's
19 capitalized, but it's 100 percent of my time. The
20 difference is now that my time will be allocated
21 through Management Services and the responsibilities
22 that I'm shifting, such as some of the planning efforts
23 that will go to other regional employees, will also be
24 allocated now through Management Services, so it's a
25 net offset. The amount of work that will be charged to

1 Kentucky will still be done; it will be with just
2 different employees.

3 Q. I probably misheard this, but did you just say that
4 basically the Director of Engineering position is going
5 to stay on the books in the future test period as far
6 as from a cost perspective? Is that accurate?

7 A. Well, I'm not sure exactly what you mean by "stay on
8 the books." We have not removed it as a transition in
9 this case, but the labor costs are still there.
10 They've just been shifted now intentionally from a
11 direct labor cost to a management fee from the region.

12 Q. To your knowledge, has anyone else in the - well, let
13 me ask you this. You say that you were promoted in
14 July. Was this part of the phased - I guess, there are
15 - my understanding is there are four different phases
16 of reorganization. I don't know if it was exclusive to
17 the Southeast Region; maybe it was American Water-wide
18 after the merger transaction was consummated, but was
19 your promotion related to the phased restructuring of
20 the Southeast Region?

21 A. My change in position was related to the reorganization
22 of the Southeast Region; yes.

23 Q. To your knowledge, has anyone else had a similar change
24 in their job duties as a result of that reorganization?

25 A. At Kentucky-American?

1 Q. Yes.

2 A. Yes.

3 Q. Who would those people be?

4 A. Rich Svindland has also, and currently Nick Rowe.

5 Q. Is it your understanding that Mr. Svindland is still
6 employed by Kentucky-American, but he's starting to do
7 things regionally, or is he now employed by the
8 regional organization?

9 A. No. I believe he stated in his testimony, like me, he
10 is an employee of the Southeast Region . . .

11 Q. Okay.

12 A. He continues to do work for Kentucky-American as well
13 as other states.

14 Q. What's your understanding of how Mr. Rowe spends his
15 time among the regions?

16 A. Well, Mr. Rowe has also been assigned to a corporate
17 position. He is again doing work in Kentucky as well
18 as for the other states.

19 Q. With these two employees aside, are you aware of anyone
20 else that's had a change in function?

21 A. Not at Kentucky, no.

22 Q. You filed - well, I won't say you filed - the company
23 filed a response in the 2001-00117 case. I guess it
24 was technically yesterday; is that correct?

25 A. Yes, sir.

1 Q. Is it my understanding, just in a general sense, that
2 it's the position of the company that, I guess, the
3 primary response to the water supply deficit issue will
4 be the Bluegrass Water Supply Commission's proposed
5 response? Is that fair to say?

6 A. I believe we indicated in a number of data requests in
7 this case that, yes, that was our intention.

8 Q. Does the company have a plan - my understanding, and
9 you can correct me if I'm wrong, but my understanding
10 of the Bluegrass Water Supply Commission is that
11 they're intending on addressing, I guess, a mid-
12 range solution, so to speak. In other words, there's
13 an immediacy issue and they are at least attempting to
14 address some of the water supply deficit issue but not
15 potentially all of it?

16 A. No, you've misunderstood, Mr. Barberie.

17 Q. Okay. So you believe that, if the Bluegrass Water
18 Supply Commission proposal is consummated, that that
19 would address entirely the long-term water supply
20 deficit issue?

21 A. I know that, if the entire Bluegrass Water Supply
22 Commission proposal is enacted and implemented, it will
23 address the entire water supply deficit for the region.

24 Q. And just so I'm clear, would that proposal include the
25 raising of the dams as well as the proposed treatment

1 and pipeline?

2 A. Not necessarily. It does not rely on the raising of
3 the dam to completely fulfill the needs of the
4 community.

5 Q. I asked Mr. Bush yesterday about the number of fire
6 hydrants, public fire hydrants, and the percentage
7 generally that are, I guess, allocated to the Urban
8 County Government.

9 A. Yes.

10 Q. And I think he said he thought, ball park, it was 5,800
11 out of 6,500.

12 A. Yes. Now, I do not have those figures. I know we
13 supplied the number of hydrants that were being billed
14 by the Lexington-Fayette Urban County Government.

15 Q. Could the company supply the Urban County Government
16 with - I simply want to know what percentage of the
17 overall public fire hydrant percentage the Urban County
18 Government makes up.

19 A. I'd be happy to. If you don't mind, I would like to
20 correct Mr. Bush's testimony. There are two sets of
21 hydrants for billing purposes, public and private. For
22 maintenance purposes, we distinguish them slightly
23 different, public, private, and privately-owned
24 hydrants, depending on where they're located.

25

1 MR. BARBERIE:

2 I don't have any other questions at this time.

3 CHAIRMAN GOSS:

4 Mr. Ingram, I saw you shake your head when Mr.
5 Barberie asked for that information. Let's get
6 that on the record. You're okay with that?

7 MR. INGRAM:

8 I am, Your Honor. We'll supply the information.

9 CHAIRMAN GOSS:

10 Okay. Thank you. Thank you, Mr. Barberie. Mr.
11 Ockerman?

12 CROSS EXAMINATION

13 BY MR. OCKERMAN:

14 Q. Good morning.

15 A. Good morning.

16 Q. Yesterday, Mr. Barberie introduced a mailing on behalf
17 of the water company to its customers and, at the time,
18 the witness didn't seem to be the appropriate witness.
19 I wonder if you are an appropriate witness to discuss
20 customer mailings with.

21 A. I can answer some questions about customer mailings.

22 Q. Okay. Before I get to that, a couple of questions
23 following up on Mr. Barberie's. I can imagine what
24 Project Delivery is. What is encompassed by Developer
25 Services?

1 A. Well, a good part of the construction that goes on with
2 Kentucky-American and with the other states is involved
3 in extending new mains for developers and that's the
4 incorporation of Developer Services including new
5 services and new main extensions.

6 Q. So this is working with commercial real estate
7 developers in getting water mains into their . . .

8 A. No . . .

9 Q. No?

10 A. No. It's working with residential developments
11 primarily that is currently part of the Engineering
12 Department. Probably a third of the construction work
13 we do at Kentucky-American is working with residential
14 developers on main extensions.

15 Q. I think you and I just said the same thing. You . . .

16 A. Well, you said commercial developments, and we don't -
17 we don't always run the mains inside a commercial
18 development, I guess, so . . .

19 Q. Okay. Okay. I had a broader definition. You've
20 identified you, Mr. Rowe, and Mr. Svindland as
21 individuals for whom formerly full-time Kentucky-
22 American jobs have now blended into partly Kentucky-
23 American, partly either regional or national, and Mr.
24 Barberie asked if you were aware of any other
25 individuals for whom that has occurred, and you said

1 no, but this is an ongoing process, this reorganiza-
2 tion, as I understand it. Do you anticipate any
3 additional jobs falling into this blended category from
4 Kentucky-American?

5 A. I believe there may be some additional jobs. I'm not
6 fully aware of the extent of those, but I know the
7 company is continuing to look at the most efficient
8 allocation of resources.

9 Q. In response to the Attorney General's Second Request
10 for Information, Item No. 14, . . .

11 A. Hang on just a second, please.

12 Q. . . . and I'll give you a moment to look at that. It's
13 not complicated, but I'll let you find it. This is
14 regarding the usage from the sources of supply and
15 usage from Jacobson Reservoir, Lake Ellerslie, and
16 Kentucky River.

17 A. You said it was the Second Data Request from the
18 Attorney General?

19 Q. Second Data Request from the Attorney General, No. 14.

20 A. Yes, sir.

21 Q. You've got a little chart there . . .

22 A. Yes.

23 Q. . . . that shows gallons of usage. On Jacobson Park
24 Reservoir, I'm unclear. There's a note at the bottom
25 that suggests that the zeros for 2003 and 2002 are a

1 netted out event, that is, water may have been drawn
2 from the Reservoir and replaced from the river. Am I
3 understanding that correctly?

4 A. Yes, that is correct. More water was transferred from
5 the river to Jacobson than was withdrawn from Jacobson
6 for treatment.

7 Q. Is that what is happening this year so far?

8 A. It started out that way, but, no; since probably July
9 that has changed.

10 Q. Can we infer from the blanks under Lake Ellerslie for
11 2001, '02, and '03 that no usage was made from Lake
12 Ellerslie?

13 A. That is correct. Lake Ellerslie is simply an emergency
14 supply.

15 Q. Okay. When the supply deficit problem is solved, as we
16 all hope it will be by this project, what will be the
17 impact on Jacobson Reservoir?

18 A. Well, Jacobson Reservoir will continue to function as a
19 supply for Kentucky-American. It's not our intention
20 to change that at all. In fact, one of the, I guess,
21 key points of the Consortium is that each one of the
22 water utilities would remain autonomous, would remain
23 complete with their operations, and only use the
24 Commission's, the Consortium's, the Bluegrass Water
25 Supply Commission's supply as a supplemental supply.

1 Q. So it's your anticipation for the indefinite future
2 that Jacobson Park and the Reservoir will all remain
3 used and useful by the utility?

4 A. Absolutely. We're counting on it.

5 MR. OCKERMAN:

6 I have some exhibits, Mr. Chairman, that I would
7 like to introduce on the topic of communications
8 with customers by Kentucky-American and, while
9 the subject matter of these letters has been the
10 public debate in Lexington over local ownership,
11 that's not the purpose for which I'm introducing
12 them. My purpose instead is to seek to identify
13 the level of employee activity in producing these
14 communications, whether that is above or below the
15 line, and, to the degree that third parties may
16 have paid for any of these communications, seeking
17 to understand and hopefully identify who those
18 may be.

19 CHAIRMAN GOSS:

20 All right. We'll take them exhibit by exhibit
21 and, if any of the parties have objections,
22 we'll hear them at the appropriate time.

23 MR. OCKERMAN:

24 All right. Exhibit No. 1, then, Bluegrass FLOW
25 Exhibit No. 1, is a letter on Kentucky-American

1 stationery, dated May 2002, addressed: "To Our
2 Valued Customers. Before I proceed, is there
3 any objection?

4 CHAIRMAN GOSS:

5 Let's give the parties just a minute or two to
6 peruse it, and then I'll ask if there's any . . .

7 MR. OCKERMAN:

8 I'll help with the perusal, because, as I say,
9 most of the text is involved in the public debate
10 and that's not what I'm asking about.

11 CHAIRMAN GOSS:

12 Okay.

13 MR. OCKERMAN:

14 If you go to the next to the last paragraph,
15 the customers are being encouraged to call, quote,
16 "our No Government Takeover hotline" at a certain
17 number, or to "email us at nogovernmenttakeover
18 @kawc.com," that being Kentucky-American's
19 website. At the very bottom of that letter, it
20 states, "This letter not paid for at customers'
21 expense."

22 CHAIRMAN GOSS:

23 Okay.

24 MR. OCKERMAN:

25 Following that is the front and back of a post-

1 card that was enclosed with that letter. At the
2 bottom of the postcard, which is the top half of
3 the page, you see again a reference to the
4 Kentucky-American Water Company website and the
5 statement "Not paid for at customers' expense,"
6 and then it's directed to be mailed back to the
7 water company, and I would also highlight, behind
8 that, the envelope itself has a postage Permit No.
9 850; the postcard has a Permit No. 1461.

10 CHAIRMAN GOSS:

11 Okay.

12 MR. OCKERMAN:

13 And my questions are who paid for this, and was
14 any company time involved in producing it, and
15 how will that be treated going forward.

16 CHAIRMAN GOSS:

17 All right. Any objection for that limited
18 purpose?

19 MR. INGRAM:

20 No, Your Honor, none.

21 CHAIRMAN GOSS:

22 Okay. Anyone else?

23 MR. SPENARD:

24 No, sir.
25

1 CHAIRMAN GOSS:

2 All right. Go ahead, then, Mr. Ockerman, and
3 proceed.

4 Q. All right, Ms. Bridwell, those are my questions. It
5 appears as though the water company is establishing the
6 No Government Takeover entity and soliciting
7 membership, and it represents that this was not paid
8 for by Kentucky-American. To your knowledge, who did
9 pay for it?

10 A. Well, to be honest with you, I would need to verify. I
11 don't know exactly who paid for it, but my guess is
12 that it was paid for by American Water.

13 Q. Okay. Then we can check that later. Obviously, if
14 that's not the correct answer, I'm sure it will be
15 supplied. So you believe it was paid for by American
16 Water. Was the Coalition Against a Government Takeover
17 originally a project of the water company? Mr. Mundy
18 refers to it as "our No Government Takeover hot-
19 line ..." "... email us at nogovernmenttakeover ..."

20 MR. INGRAM:

21 Your Honor, I fail to see the relevance of that
22 question. We've repeatedly stated there are
23 absolutely no anticondemnation or antitakeover
24 expenses included in the cost of service for
25 Kentucky-American for the forecasted test year.

1 MR. OCKERMAN:

2 And I appreciate Mr. Ingram's representation, but
3 that's not testimony, and I'm seeking to be sure
4 that there have been no items overlooked because
5 this was over in a different category when the
6 budget was put together.

7 CHAIRMAN GOSS:

8 I think the - anyone else want to weigh in? I
9 think the question probably is relevant, and I'll
10 overrule the objection. Go ahead.

11 A. Could you repeat the question again?

12 Q. Was the Coalition originally an in-house project of the
13 water company?

14 A. No, absolutely not.

15 Q. Can you explain how Mr. Mundy refers to it as "our No
16 Government Takeover" and the communications are
17 directed back to the water company?

18 A. Well, I think Mr. Mundy was, I guess, a part of, a
19 layer of, the Coalition. Certainly, he's supportive of
20 the Coalition, but it was not an entity created by
21 Kentucky-American in any way, shape, or form.

22 Q. Then how do you explain the continual cross-references
23 back to the official Kentucky-American Water Company
24 website and the mailing it back - is this the - P.O.
25 Box 22608, is that the official water company mailbox?

1 A. Not that I'm aware of. I don't think we have a P.O.
2 Box, but I'm not sure.

3 Q. Can you explain the cross-references?

4 A. Well, I think, because the issue is related to
5 Kentucky-American, Mr. Mundy is, in this letter, taking
6 ownership of the issue but not necessarily the - when I
7 read this, I do not take this to necessarily mean that
8 Mr. Mundy is taking ownership of the Coalition itself.

9 MR. OCKERMAN:

10 All right. Let me introduce Bluegrass FLOW
11 Exhibit No. 2.

12 CHAIRMAN GOSS:

13 For the record, FLOW Exhibit No. 1 will be
14 introduced as a formal exhibit.

15 BLUEGRASS FLOW EXHIBIT 1

16 MR. OCKERMAN:

17 Or I offer this as Exhibit No. 2 and see if . . .

18 BLUEGRASS FLOW EXHIBIT 2

19 Q. This is a letter, again, on Kentucky-American
20 stationery, dated October 2002, and, again,
21 to illustrate the points I would like focused
22 on, the next to the last paragraph, once again,
23 encourages a Kentucky-American customer to join
24 the Coalition so that "Your voice will then be heard."
25 So now we understand that the Coalition is not a part

1 of the water company. So this is not a communication
2 to a customer about water company business. There is
3 not a statement at the bottom of this page as to who
4 paid for it whereas there was on the first letter. The
5 postcard you'll see has a "Not paid for at customers'
6 expense" statement although the letter omits that. We
7 have new mailing permits and new websites, and this is
8 now directed to the Coalition's mailbox. So, again, my
9 question is, who prepared this, who paid for it, and
10 why is the water company encouraging its customers to
11 join a different entity?

12 A. Well, let me start with the last question. I believe,
13 if I read the last question, it says, "If you wish ..."
14 "... Kentucky-American ..." to "... continue ...",
15 please "... join the Coalition." I don't think they're
16 necessarily encouraging all the customers; only if they
17 agree with the context of the letter. Certainly, this
18 letter on an issue that's very important to Kentucky-
19 American is a business of Kentucky-American. Now, as
20 we've stated repeatedly, the cost of producing and
21 providing information to our customers on the condemna-
22 tion is not included anywhere in this rate case nor was
23 it paid for by Kentucky-American.

24 Q. It doesn't bother you that customer information is
25 being used to benefit a third-party entity by driving

- 1 membership towards them?
- 2 A. I guess . . .
- 3 Q. This is not the economic side of my question; this is
4 the customer privacy side of my question.
- 5 A. I guess, in the sense that Kentucky-American is sending
6 information to its customers about an issue, even if it
7 is related or is directing a response back to a third
8 party, it is still dealing with the business of
9 Kentucky-American Water. It's not being paid for by
10 the customers, but it is dealing with the business of
11 Kentucky-American Water.
- 12 Q. If you'll look at the next to the last page, the
13 postcard has a bar code across the bottom of this. Are
14 you familiar with that type of bar code?
- 15 A. Only that I see them on a lot of mail.
- 16 Q. Could that be a particular customer label type bar
17 coding?
- 18 A. I have no idea.
- 19 Q. Do you have handy the exhibit Mr. Barberie introduced
20 yesterday?
- 21 A. No, but I'm familiar with it.
- 22 Q. Are you familiar with the fact that it has a very
23 similar bar code across the addressed part of that
24 mailing?
- 25 A. Yes. Well, I mean, I would take your word for it that

1 it was similar.

2 Q. It's not exactly the same. I have compared the bars
3 and they do change after about 15 instances, but you
4 don't know whether that is a customer identity bar
5 code?

6 A. Not on this particular document, Exhibit 2; no.

7 Q. Mr. Barberie started to get into categories of communi-
8 cations with customers yesterday, and I am about as
9 unfamiliar with those categories as he alleged that
10 he was. Can you give me a range of permissible to
11 impermissible types of communications, three or four
12 examples to give us a bar?

13 A. I guess I'm not understanding what you're asking me.

14 Q. Well, for example, I know the statutes forbid the use
15 of a customer list to a utility affiliate for purposes
16 of cross-selling services without the customer's
17 permission.

18 A. That's my understanding.

19 Q. So that's clearly outside whatever line would be drawn,
20 and communications, I would presume, with customers
21 with regard to water conservation, water quality, those
22 kind of issues, would be clearly permissible.

23 A. That's my understanding.

24 Q. Where, in your understanding, does encouraging a
25 customer to join a third-party membership organization

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fall?

A. I guess, in my opinion, and I am obviously not a lawyer, but, in my opinion and from what I understand, the company's right to provide information to its customers about an issue that is relevant to the water company and its continued business is perfectly within our rights to provide it through our mailing list. It doesn't necessarily mean that we have the right to collect those fees through advertising, the cost for those, through the ratepayers.

Q. So a letter to a customer that talks about, "Here's a big issue. Here's the company's stand on this issue. If you agree with us, here's something you can do," is okay?

A. That's my understanding of it. Again, I'm not a lawyer so I wouldn't represent a legal position.

Q. And I'm not asking you for a legal opinion.

MR. OCKERMAN:

Let me now offer - I presume . . .

CHAIRMAN GOSS:

Let's go ahead and formally, if there's no objection, formally move admission of FLOW Exhibit No. 2.

BLUEGRASS FLOW EXHIBIT 2

1 MR. OCKERMAN:

2 Okay. This is my last letter to introduce.
3 This is dated December 2002. I offer it as
4 Bluegrass FLOW Exhibit No. 3, also on Kentucky-
5 American letterhead, also from Mr. Mundy.

6 BLUEGRASS FLOW EXHIBIT 3

7 CHAIRMAN GOSS:

8 Thank you.

9 Q. Now, this letter, I submit, is of a very different
10 character than the prior two letters. At the end of
11 the very first paragraph, we've gone beyond neutral
12 statements of position and analysis of issues. The
13 statement now, "It is risky for you and a bad idea for
14 Lexington" to take the course of action contrary to
15 that advocated by the water company. On the second
16 page, you see a number of emphasized statements,
17 underlined, highlighted, some in bold and underlined.
18 At the next to the last paragraph on Page 3, there is
19 again support given to the Coalition. "If you agree
20 that a takeover is bad for Lexington, we encourage you
21 to join the Coalition ..." Here's how to do it.
22 "... visit the Coalition website ..." "... we ask that
23 you help us build the Coalition ..." involve your
24 "... family members, friends and neighbors ..." Again,
25 an omission of who paid for it, with the bar coding on

1 the postcard and the "Not paid for at customers'
2 expense." The same series of questions; the difference
3 being in this case we have gotten beyond neutral
4 statements by the utility. We've got a scare letter
5 sent to customers. Did American Water Works pay for
6 this?

7 MR. INGRAM:

8 Your Honor, I object to the adjective "scare"
9 there. That's like beauty; it's in the eye of the
10 beholder.

11 CHAIRMAN GOSS:

12 Well, I agree. I don't know that we need to be
13 using that sort of language. Certainly, the
14 letter speaks for itself and we'll leave it at
15 that, but I think the question - I'll sustain the
16 objection in that regard, but I think the question
17 to the witness is appropriate. Go ahead and
18 answer it.

19 A. And let me state up front, again, I am not familiar
20 with the exact details on all of these letters, but it
21 is my understanding that all of the correspondence that
22 was sent from the company on this issue was paid for by
23 American Water.

24 Q. Okay, and, if we got into the appropriate accounting
25 records, Mr. Mundy's time in authoring or editing this

1 letter would have been credited against American Water
2 as opposed to Kentucky-American and anybody else who
3 was involved in the production, the printing, and the
4 mailing?

5 A. To be honest with you, I know there were some data
6 responses about that. I don't know the exact answer on
7 how Mr. Mundy's time has been treated.

8 Q. Do we know the ownership of Postal Permits 269, 372,
9 850, and 1461?

10 A. The only one I am familiar with is Permit No. 372 and
11 that is owned by Kentucky-American Water.

12 Q. Can we be supplied the ownership of the other, if you
13 have that information?

14 A. I can tell you whether or not they're owned by
15 Kentucky-American, and that's all I can verify for
16 you.

17 Q. That's fine. If you would do that, I'd appreciate it.

18 MR. INGRAM:

19 Could you repeat the list, please?

20 MR. OCKERMAN:

21 The numbers - No. 372 has been identified as
22 Kentucky-American. The other three are No. 269,
23 No. 850, and No. 1461, and I understand that
24 the information I get will be this is either a
25 Kentucky-American postage permit or it's not.

1 MR. INGRAM:
2 Okay. Thank you.
3 CHAIRMAN GOSS:
4 Do you agree to that, Mr. Ingram, to provide
5 that?
6 MR. INGRAM:
7 Yes, Your Honor. We certainly will.
8 CHAIRMAN GOSS:
9 Thank you.
10 Q. Okay. Just three or four more questions and I'll be
11 through here. You are aware that Kentucky-American
12 Water Company is listed as a member organization to the
13 Coalition Against a No (sic) Government Takeover?
14 A. I was not aware of that listing.
15 Q. You're not aware of that?
16 A. Uh-huh.
17 Q. Would Mr. Miller be aware of membership information
18 regarding the Coalition?
19 A. Mr. Miller? Herb Miller?
20 Q. No; Mike.
21 A. No. Mike would not be aware of the membership list of
22 the Coalition.
23 Q. The questions I'm - I'll ask you generally this
24 question and, if you don't have the answer, then that
25 will be it. My question is regarding the membership

1 duties of a member of the Coalition, whether any dues
2 are paid, whether anything of direct or indirect value,
3 such as office space, staffing, phones, postage, was
4 supplied by the water company to the Coalition through
5 its membership role or otherwise.

6 A. I have no idea. I know that none of the support to the
7 Coalition has been from Kentucky-American directly in
8 dollars.

9 Q. Has it been indirectly?

10 A. Well, obviously the employees of Kentucky-American have
11 been supportive of the Coalition, both on their own
12 time, mainly on their own time.

13 Q. Partially on company time?

14 A. Where - some management employees where they're not
15 paid by the hour, some of them have been during what
16 might be considered the workday.

17 Q. Thank you.

18 MR. OCKERMAN:

19 That's all, Mr. Chairman.

20 CHAIRMAN GOSS:

21 Thank you. Mr. Wuetcher, do you have questions?

22 MR. WUETCHER:

23 Just a few, Your Honor.
24
25

1 CROSS EXAMINATION

2 BY MR. WUETCHER:

3 Q. Let's shift gears for a moment and go back to Tri-
4 Village Water District.

5 A. Okay.

6 Q. Can you identify any specific cost savings that
7 Kentucky-American obtained from its purchase of Tri-
8 Village Water District?

9 A. Cost savings on behalf of Tri-Village or on Kentucky-
10 American Water?

11 Q. On Kentucky-American Water.

12 A. Not specifically, other than the economics of having
13 the additional customers, just providing the economies
14 of scale on purchasing, shared resources, that sense.
15 I can't quantify those specifically. I would say it's
16 probably pretty small since it's not a contiguous
17 system to Kentucky-American.

18 Q. Okay. Can you identify any specific cost savings to
19 Kentucky-American as a result of the purchase of Elk
20 Lake?

21 A. Again, because the system is so much smaller, it would
22 probably be even smaller than other than the economies
23 of scale. There's probably very little.

24 Q. I'd like to refer to your rebuttal testimony, Page 3,
25 Lines 25 through 31.

1 A. Okay.

2 Q. And now I have to find it. I believe at those lines
3 you state that preventative maintenance costs were one
4 area that was reduced as a result of security costs
5 that have been deferred.

6 A. Yes.

7 Q. Can you quantify the amounts of the preventative
8 maintenance costs that were reduced?

9 A. That would be very difficult to do. We might be able
10 to make an attempt through - preventative maintenance
11 costs, there are some that can be deferred and some
12 that obviously cannot be deferred and some of those on
13 equipment maintenance, valve operations, those sort of
14 things, that was part of the reduction in the
15 preventative maintenance over those two years.

16 Q. So I take it that some of those costs would be ones
17 that would have been regularly scheduled that you could
18 at least identify, . . .

19 A. Yes.

20 Q. . . . but others would be harder to quantify?

21 A. Yes, they'd be harder to quantify specifically.

22 Q. To the extent that you can at least identify those that
23 were scheduled and deferred as a result of the
24 increased security costs, could you provide those for
25 us?

1 A. We can try.

2 Q. Okay.

3 CHAIRMAN GOSS:

4 Hold on there a second, Mr. Wuetcher. Mr.
5 Ockerman, did I formally admit your Exhibit No. 3?

6 MR. OCKERMAN:

7 I don't think you did, sir.

8 CHAIRMAN GOSS:

9 I don't think I did. Let's go ahead, if there's
10 no objection, and admit FLOW Exhibit No. 3.

11 MR. OCKERMAN:

12 Thank you.

13 BLUEGRASS FLOW EXHIBIT 3

14 CHAIRMAN GOSS:

15 Sorry about that. Go ahead, Mr. Wuetcher.

16 MR. WUETCHER:

17 Thank you, sir.

18 Q. To the extent of your knowledge, were there any other
19 areas of expenses that were reduced as a result of the
20 level of security costs?

21 A. No, other than some of the capital expenditures were
22 obviously diverted from other areas into the security
23 capital costs, but, no. Unfortunately, a lot of it was
24 just spending a lot of extra hours on management
25 personnel trying to implement some of this.

- 1 Q. Did the reduction or cutting of preventative
2 maintenance costs in the years - the references that
3 you've made to the reduction of preventative
4 maintenance costs, did they result in forecasted
5 maintenance expenses that are higher in this case than
6 what otherwise would have been experienced?
- 7 A. No. It's my understanding that we're really just
8 trying to get the preventative maintenance costs back
9 to the 2001 level that would be normal operating
10 levels.
- 11 Q. I'd like to refer to Kentucky-American's Response to
12 the Fourth Set of Commission Staff's Information
13 Requests. I think it's Item 7.
- 14 A. Okay.
- 15 Q. I'm trying to make sure I understand the Response to
16 Section g. regarding the removal of sedimentation at
17 the Richmond Road Station.
- 18 A. Yes.
- 19 Q. The schedule that's provided shows solids generated at
20 the Richmond Road Station to be at a consistent level
21 during the years of 2002, 2003, and 2004 at the amounts
22 of 3,330 tons, 3,904 tons, and 3,620 tons respectively;
23 is that correct?
- 24 A. I'm sorry. Are you looking at the attachment to g.?
- 25 Q. I'm looking at the attachment; yes, ma'am.

1 A. Okay. I'm sorry. Read those numbers again.
2 Q. Okay. For 2002, it would be 3,300.
3 A. At Richmond Road Station?
4 Q. Give me just one second. Okay. Let me try again. If
5 you look at the schedule, the number of cumulative tons
6 for 2002 is 3,630?
7 A. Yes, sir.
8 Q. And then, for 2003, it's 3,904?
9 A. Yes, sir.
10 Q. And then, for 2004, it's 3,620?
11 A. Yes.
12 Q. Would it be correct to say that that's a pretty
13 consistent amount? The level has not increased
14 dramatically?
15 A. Well, actually, if you look through - I don't think
16 that's a fair characterization, which is why the
17 cumulative tons over to the side I have bolded the
18 number through October, which the cumulative tons for
19 2002 through October were 3,287; for 2003, were 3,423
20 tons; and, through 2004, were 3,620. That's it
21 continually just gradually increasing.
22 Q. I think you've answered our question.
23 A. Okay.
24 Q. I need to refer you to - let me refer you to Work
25 Paper 1-1, Utility Plant in Service.

1 A. Okay. I think I'm going to need that one.
2 Q. At Page 10.
3 A. Okay. Hang on just a second. I don't have that one.
4 Page 7 of 24? Is that what you said?
5 Q. Page 10 of 24.
6 A. Okay.
7 Q. Okay. I have a question concerning two of the items.
8 On that page, it should be for the Utility Plant in
9 Service, the Central area. Do you have that?
10 A. Yes. That's my understanding. That's what it says at
11 the top.
12 Q. Okay. I'm moving down. There are two items, about the
13 third and fourth items, the account title is "OTHER PIE
14 INTANGIBLES." Do you have that?
15 A. Yes.
16 Q. Okay. There's a change in the depreciation rates. The
17 current depreciation rate is listed as "0.00%" and the
18 proposed depreciation rate is listed as "10.00%." Why
19 do these two rates differ? What's the reason for the
20 change?
21 A. To be honest with you, I'm not the witness that you
22 need to ask this to. I don't know whether it will be
23 Mr. Miller or Ms. Valentine.
24 Q. Okay. That's fair enough.
25

1 MR. WUETCHER:

2 That's all we have. Thank you.

3 CHAIRMAN GOSS:

4 Okay. Redirect, Mr. Ingram?

5 MR. INGRAM:

6 Just a couple of questions, Your Honor.

7 REDIRECT EXAMINATION

8 BY MR. INGRAM:

9 Q. Ms. Bridwell, would the allocation of some management
10 and employee time from Kentucky-American Water Company
11 to Tri-Village and Elk Lake services benefit the
12 customers of Kentucky-American Water Company?

13 A. Yes, there would be some benefit there if the
14 allocation is made to the Tri-Village and Elk Lake
15 customers.

16 Q. Do you understand that the allocation has been made in
17 this case?

18 A. Yes, I do.

19 Q. That would be in addition to the economies of scale of
20 sometime in the future adding the customers of Elk Lake
21 and Tri-Village under a single priced tariffing
22 structure; would it not?

23 A. Yes, in addition to the economies of scale we're
24 already realizing.

25 Q. Thank you.

1 MR. INGRAM:

2 That's all, Your Honor.

3 CHAIRMAN GOSS:

4 Mr. Spenard?

5 MR. SPENARD:

6 No questions.

7 CHAIRMAN GOSS:

8 Mr. Ockerman?

9 MR. OCKERMAN:

10 One follow-up, just so I'm clear.

11 RE CROSS EXAMINATION

12 BY MR. OCKERMAN:

13 Q. Is it your understanding that anytime a statement is
14 made similar to the following, something is "Not paid
15 for at customers' expense," or "Paid for by the
16 shareholders of Kentucky-American," that that is a
17 reference to American Water Works having paid for
18 something?

19 A. Not necessarily.

20 Q. What would be the other alternatives?

21 A. I mean, it can be paid for by any outside party,
22 but . . .

23 Q. Are you aware - let me ask it this way. To your
24 personal knowledge, have there been any other than by
25 American Water Works?

1 A. To be honest, I have not been personally involved with
2 all of the additional expenses that have gone out.

3 Q. Thank you.

4 CHAIRMAN GOSS:

5 Mr. Barberie, anything further?

6 MR. BARBERIE:

7 Yeah, I have just two, I think.

8 RE CROSS EXAMINATION

9 BY MR. BARBERIE:

10 Q. Ms. Bridwell, I think you testified that the
11 reorganization apparently is not closed out yet. Do
12 you have an understanding, as an employee, as to what
13 the expected reorganization finalization date would be?

14 A. Well, I guess the characterization there is slightly
15 unfair.

16 Q. I didn't mean to characterize it that way, but . . .

17 A. No . . .

18 Q. . . . I understood you to say that the process is still
19 ongoing.

20 A. Well, I think Kentucky-American, like a lot of American
21 businesses today, is continuing to look, and American
22 Water in general is continuing to look at reorganiza-
23 tion. Obviously, we are shifting job duties fairly
24 significantly over the last few months and there may
25 continue to need to be some changes through the next

1 year or two years. I don't think it's ever an ending
2 process. I do know that there's no scheduled
3 additional phased hiring or change of jobs.
4 Q. Okay. So you're telling me that the proposed phase of
5 restructuring, that part, is over?
6 A. That's my understanding.
7 Q. So there's no formal - there's no further formal
8 reorganization proposal; is that correct?
9 A. That is my understanding at this point.
10 Q. You probably answered this before, but I'm kind of slow
11 this morning, so, with respect to the treatment of your
12 salary and overhead in this case, what is your under-
13 standing of how that's being proposed to be done?
14 A. When the case was filed, my salary and overhead, which
15 was all capitalized dollars in this case, was as a
16 direct employee of Kentucky-American Water. Going
17 forward, my salary and overhead capitalized will be
18 charged through management fees through the Southeast
19 Region. So there will be a reduction of the direct
20 labor costs at Kentucky-American, but there will be an
21 increase of management fees.
22 MR. BARBERIE:
23 That's all I have.
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EXAMINATION

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BY CHAIRMAN GOSS:

Q. You're saying that would be a wash?

A. That is my understanding, is that it would be a wash.

Q. All right.

CHAIRMAN GOSS:

Mr. Wuetcher?

MR. WUETCHER:

No questions.

CHAIRMAN GOSS:

Okay. Thank you. Does the Commission have any questions? I failed to ask.

COMMISSIONER COKER:

No.

CHAIRMAN GOSS:

Thank you, Ms. Bridwell. We appreciate it. You may step down. Okay. Let's go ahead, then, and take a lunch break before Mr. Ingram calls his next witness. Because some of you all are having to go out into town to eat, let's take until one-thirty. That's an hour and about 20-25 minutes. Yes, sir, Mr. Spenard?

MR. SPENARD:

Mr. Chairman, with the - to advise the - is it recommended that I advise the Commission at this

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stage?

MR. WUETCHER:

Your Honor, the Attorney General has a witness who is required to leave by the end of the day, and the Commission Staff and Kentucky-American and the other parties have agreed that that witness would be taken out of order as soon as we return from the lunch break.

CHAIRMAN GOSS:

Sure. Okay. Can we do it - I don't know. Does this person have a plane to catch or something? Can we do it after lunch, or do you want to do it now?

MR. SPENARD:

After lunch is fine.

CHAIRMAN GOSS:

Okay. All right. Is that okay with you?

MR. INGRAM:

Absolutely.

CHAIRMAN GOSS:

Okay. I appreciate the agreement to do that. We'll be then in recess until one-thirty.

OFF THE RECORD

CHAIRMAN GOSS:

Okay. Mr. Ingram, do you want to call your

1 next witness, sir?

2 MR. INGRAM:

3 Your Honor, I think we've agreed to take an
4 Attorney General's witness.

5 CHAIRMAN GOSS:

6 That's right. That's right. Would you name
7 your witness and call him forward, please, Mr.
8 Spenard?

9 MR. SPENARD:

10 Yes, sir, Mr. Chairman. Dr. J. Randall
11 Woolridge.

12 WITNESS SWORN

13 The witness, J. RANDALL WOOLRIDGE, after having
14 been first duly sworn, testified as follows:

15 DIRECT EXAMINATION

16 BY MR. SPENARD:

17 Q. Good afternoon. Please state your name.

18 A. My name is the initial J. Randall Woolridge,
19 W-o-o-l-r-i-d-g-e.

20 Q. And you've been retained by the Office of the Attorney
21 General to provide expert testimony in this case?

22 A. Yes.

23 Q. And, as part of that, you prefiled some direct
24 testimony back in August?

25 A. Yes.

1 Q. And, at this stage, do you have any corrections,
2 deletions, changes, or other modifications to that
3 testimony?
4 A. No.
5 Q. Okay. So, if I were to ask you the same questions
6 today that are contained in your direct testimony, your
7 answers would be the same?
8 A. Yes.
9 Q. Okay.
10 MR. SPENARD:
11 At this stage, I will tender the witness for
12 cross examination.
13 CHAIRMAN GOSS:
14 Okay, Mr. Spenard. Mr. Ingram?
15 MR. INGRAM:
16 Thank you.
17 CROSS EXAMINATION
18 BY MR. INGRAM:
19 Q. Good afternoon, sir.
20 A. Good afternoon.
21 Q. Is this your first time testifying in Kentucky?
22 A. Yes.
23 Q. Do you agree with me that the smaller the component of
24 common equity in a capital structure the greater the
25 financial risk is to the shareholder?

1 A. Everything else - yes. Everything else equal and
2 within a certain range, yes, I agree with that.

3 Q. Does it follow from that that the greater the
4 shareholder financial risk the more the expectation is
5 that that shareholder should receive a higher return on
6 the investment?

7 A. Yes. As a general proposition, I agree.

8 Q. Sure. Sure. I want to talk to you, Dr. Woolridge,
9 about a presentation you made November 19, 2003 to the
10 National Association of State Utility Consumer
11 Advocates, and I will give to you and ask to be marked
12 for identification two PowerPoint slides I think you
13 used in that presentation, and I'll wait until they're
14 distributed.

15 MR. INGRAM:

16 Your Honor, could I have this marked Kentucky-
17 American's next hearing exhibit, whatever that
18 may be?

19 CHAIRMAN GOSS:

20 Yes. I think it's No. 3.

21 KAWC EXHIBIT 3

22 MR. INGRAM:

23 Thank you.

24 Q. Are these two of the PowerPoint slides you used in that
25 presentation?

1 A. No.

2 Q. Did you prepare these PowerPoint slides?

3 A. Yes, I prepared these. It turns out I never made this
4 presentation.

5 Q. Ah. Well, you were prepared to make this presentation,
6 I take it.

7 A. I was.

8 Q. Okay, and that is your name on Slide 1; right?

9 A. Yes.

10 Q. And it was a presentation scheduled for November 19,
11 2003?

12 A. Yes.

13 Q. And, had you been allowed to make that presentation,
14 you would have used, I take it, the slide on the second
15 page?

16 A. Yes, I believe I would.

17 Q. Okay, and I take it the theme of this presentation is
18 that commissions are allowing returns below 10 percent;
19 is that correct?

20 A. Yes. I think, though, the theme of this slide at that
21 time was that there were cases where decisions were
22 made allowing returns on equity less than 10 percent.

23 Q. And, in support of that hypothesis, you have two water
24 companies listed on the second page of this exhibit; do
25 you not?

1 A. Yes.

2 Q. The first listed one is Tennessee-American Water
3 Company with a date of decision of June 27, 2003; is
4 that correct?

5 A. Yes.

6 Q. With an allowed return of 9.9 percent?

7 A. Yes.

8 Q. Did you consider it relevant or important to include on
9 this PowerPoint slide the fact that that was an agreed
10 upon decision?

11 A. No. I had not put this slide - I mean, I hadn't put
12 this database together. I believe I got this from
13 somebody in the Consumer Advocate Office at
14 Pennsylvania, so I really hadn't done a lot of investi-
15 gation about whether these were actual litigated
16 proceedings or simply were agreements. I didn't put
17 anything in there about their capital structure ratios,
18 that sort of thing. So I didn't know a lot of the
19 details of these. These are just examples.

20 Q. Sure. Would it be important to you, if you represented
21 that that return was 9.9 percent, to know that the
22 common equity portion of the capital structure of
23 Tennessee-American at that time was 71.4 percent?

24 A. That would be relevant, but, of course, a lot of other
25 issues related to the case would be relevant as well.

1 So it's not just the capital structure that's the
2 important ingredient in terms of determining what the
3 appropriate return on equity should be.
4 Q. The other example you cited in the water business is a
5 utility called Cypress Lakes Utilities; am I correct?
6 A. Yes.
7 Q. A February 10, '03 decision from Florida?
8 A. Yes.
9 Q. With a return on equity of 9.93 percent?
10 A. Yes.
11 MR. INGRAM:
12 Your Honor, if there's no objection, I'd like to
13 have my first numbered exhibit admitted into
14 evidence, please.
15 CHAIRMAN GOSS:
16 I think, if we didn't do that, we'll do it now.
17 That was the . . .
18 MR. INGRAM:
19 Two-page . . .
20 CHAIRMAN GOSS:
21 Well, no. The first exhibit - are you talking
22 about Exhibit No. 3, the exhibit you just went
23 over?
24 MR. INGRAM:
25 Yes.

1 CHAIRMAN GOSS:

2 All right. Without objection, that's admitted.

3 KAWC EXHIBIT 3

4 MR. INGRAM:

5 And if I could have the next exhibit marked for
6 purposes of identification as Kentucky-American's
7 Exhibit No. 4, please.

8 KAWC EXHIBIT 4

9 Q. Dr. Woolridge, let me direct your attention to Page 5
10 of the Order that says on its face - it is dated
11 February 10, 2003, before the Florida Public Service
12 Commission, in the matter of the Application for rate
13 increase in Polk County by Cypress Lakes Utilities.
14 Page 5 of the Order says in the second sentence, does
15 it not, and I quote, "First, pursuant to Section
16 367.082, Florida Statutes, the required rate of return
17 for an interim increase for a utility that has never
18 had an authorized ROE shall be calculated using the
19 minimum of the range of the current equity leverage
20 formula." And on down in that same paragraph, "Using
21 the 2002 leverage formula and Cypress Lakes' adjusted
22 equity ratio, we calculated an ROE of 10.93%, with a
23 range of 9.93% to 11.93%. Using the minimum of the
24 range, for interim purposes, we find the proper cost of
25 equity is 9.93%." Is that correct?

1 A. Yes.

2 Q. And that was your representation on this slide; was it
3 not?

4 A. Yes.

5 Q. Did you make any effort to determine what happened to
6 the ROE for Cypress Lakes Utilities after the date of
7 that Order?

8 A. No.

9 MR. INGRAM:
10 Could I have the next exhibit marked as Kentucky-
11 American's Exhibit No. 5 for identification,
12 please, Your Honor?

13 KAWC EXHIBIT 5

14 COURT REPORTER:
15 Could I have No. 4?

16 CHAIRMAN GOSS:
17 Four is what he just went over. You don't have
18 it? Do you want to go ahead and move for
19 admission of No. 4, Mr. Ingram?

20 MR. INGRAM:
21 Yes, Your Honor.

22 CHAIRMAN GOSS:
23 Is there any objection?

24 MR. SPENARD:
25 No objection.

1 CHAIRMAN GOSS:

2 All right. Let it be entered, then.

3 KAWC EXHIBIT 4

4 Q. Dr. Woolridge, let me direct your attention to Page 21
5 of this Order, which is dated May 28, 2003. The last
6 sentence on that page, is it not, quote, "The ROE shall
7 be 10.93%, with a range of 9.93% to 11.93%"?

8 A. Yes.

9 Q. Is it true, then, that before your proposed
10 presentation to the National Association of State
11 Utility Consumer Advocates, which you intended to make
12 on November 19, 2003, Florida had, in fact, not awarded
13 Cypress Lakes Utilities a 9.93 percent return on
14 equity?

15 A. Again, I don't know the details of the case. I could
16 spend some time going over this if you wanted me to,
17 but, I mean, it appears there was an adjustment. I
18 don't know, again, not being involved in the case, not
19 knowing the entire record, I don't know all the
20 details. So, reading that one sentence, that would
21 presume to be what the case is, but I really don't
22 know.

23 Q. Thank you. You have proposed a hypothetical capital
24 structure for Kentucky-American Water Company for this
25 rate proceeding; have you not?

1 A. No, I don't think I would characterize it as - I mean,
2 maybe it's using the word "hypothetical." I would say
3 I'm proposing an actual capital structure which is
4 based on the average of three years, but I guess maybe
5 it just deals with the semantics of calling it a
6 hypothetical.

7 CHAIRMAN GOSS:

8 Excuse me just a second, Mr. Ingram. Do you want
9 to move for admission of that exhibit?

10 MR. INGRAM:

11 Thank you, Your Honor. I will.

12 CHAIRMAN GOSS:

13 Any objection?

14 MR. SPENARD:

15 No objection.

16 CHAIRMAN GOSS:

17 Okay. Let's go ahead and let it be admitted,
18 then.

19 MR. INGRAM:

20 Thank you. I apologize.

21 CHAIRMAN GOSS:

22 No. That's all right.

23 KAWC EXHIBIT 5

24 CHAIRMAN GOSS:

25 Okay, Mr. Ingram. Go ahead.

- 1 Q. Has the capital structure that you have proposed ever
2 existed historically for Kentucky-American?
- 3 A. I really don't know if it has. I mean, obviously it's
4 an average of the quarterly capitalizations over three
5 years. Over that time period, maybe it did; maybe it
6 didn't. I don't know.
- 7 Q. Well, would you take it from me, subject to check,
8 that, during the three years that you examined, it has
9 never, in fact, existed?
- 10 A. I don't know if I could accept that, because, I mean,
11 obviously, quarter to quarter, things change. At some
12 point the capitalization could have been that. I don't
13 know.
- 14 Q. Are you familiar with the regulations of the Public
15 Service Commission of the Commonwealth of Kentucky with
16 respect to the requirements for filing a forecasted
17 test year?
- 18 A. I've generally become knowledgeable about them; not in
19 a lot of depth, but I do know there are some
20 regulations about how a case is to be presented.
- 21 Q. You understand that the company is required to present
22 capitalization and net investment rate base based upon
23 a 13-month average for the forecasted period; do you
24 not?
- 25 A. Yes, I do understand. I think I responded in an

1 interrogatory to that from the Commission Staff.

2 Q. Doesn't your hypothetical capital structure ignore the

3 long-term debt issue of \$14 million sold by Kentucky-

4 American Water Company on March of 2004?

5 A. No. Actually, part of the reason that I used the

6 three-year average quarterly capitalization is because

7 the company had refinanced recently, in the spring of

8 this year, the short-term debt and, as a result, the

9 proposed capital structure, I thought, didn't reflect

10 the way the company had actually financed themselves in

11 the immediate past three years.

12 Q. Your hypothetical capital structure is based on the

13 average of the quarters for three years beginning with

14 2001 and ending with December 2003; is that correct?

15 A. That's correct.

16 Q. It does not include the capital structure or any

17 financing that originated in the capital structure in

18 March of 2004; does it?

19 A. That's correct.

20 Q. And likewise your hypothetical capital structure does

21 not consider the proposed financing of \$5.5 million

22 scheduled for September of 2005; does it?

23 A. No, I believe it does not.

24 Q. It likewise does not include the accumulation of

25 retained earnings from August of 2004 to November of

- 1 2005; does it?
- 2 A. No, it doesn't, but, if you look at the numbers, the
3 common equity ratios are quite similar between my
4 capital structure and the proposed capital structure of
5 the company. The only real difference, big difference,
6 is the percent of long-term debt versus short-term
7 debt. So, in actuality, the common equity ratios are
8 quite similar.
- 9 Q. And your proposal is to increase the short-term debt
10 over the capital structure presented by Kentucky-
11 American by more than double; am I not right?
- 12 A. Yes, because that's historically the way they finance
13 themselves.
- 14 Q. But that's not the way it's going to be financed in the
15 forecasted test year; is it?
- 16 A. If what they forecast turns out to be in the case, then
17 that's true.
- 18 Q. Have you looked at any past Orders from this Commission
19 for Kentucky-American Water Company where a forecasted
20 test year has been utilized?
- 21 A. I have looked at some past Orders. I don't remember
22 exactly how the capital structure was determined. So I
23 have looked at them. I just don't remember.
- 24 Q. Are you aware that there have been five Orders from
25 this Commission for Kentucky-American Water Company

1 utilizing a forecasted test year?

2 A. No, I'm not.

3 Q. I take it, then, you would not know that they are

4 Orders numbered 92-452, 94-197, 95-554, 97-034, and

5 2000-120?

6 A. No. I know I've looked at several of those. I

7 wouldn't remember the numbers.

8 Q. Would you know whether or not the Commission has ever

9 used anything in those five Orders other than the 13-

10 month average capital structure for the forecasted test

11 year?

12 A. No.

13 Q. If there is absolutely no historical precedent in the

14 Commonwealth of Kentucky, no legal precedent, for the

15 use of a hypothetical capital structure in a forecasted

16 test year, were you aware of that?

17 A. No, but, again, I think - I've testified in a lot of

18 states and it seems that you want to set a capital

19 structure which fits the way a company finances itself

20 over time. In other words, the capital structure

21 should reflect the company's financial strategy and one

22 way you can look at that is just see how they've done

23 it in the past.

24 Q. If the going-forward financial strategy is different

25 than the historical financial strategy, then the

1 hypothetical capital structure based on history does
2 not comport with your statement; does it?

3 A. I would say yes and no. It depends. It depends if
4 what's going forward in the projections actually turns
5 out to be true.

6 Q. Do you agree with me that a forecasted capital
7 structure is designed to meet the capital needs during
8 the forecasted test year?

9 A. Yes. I mean, in terms of - under the assumption that
10 what the company forecasts out in the future actually
11 turns out they occur.

12 Q. Do you agree with me that capital requirements change
13 continually?

14 A. I think capital requirements change and companies adopt
15 their operating and capital planning budgets based on
16 changes.

17 Q. You don't question the mathematics of Kentucky-
18 American's proposed 13-month average capital structure
19 for the forecasted test year; do you?

20 A. No. I haven't gone about any analysis to determine if
21 it's appropriate or not.

22 Q. In your recommendation to this Commission on behalf of
23 the Attorney General, you have stated that your group
24 of small water companies is most appropriate to use for
25 a proxy for Kentucky-American; am I right?

1 A. Yes. As a general rule, I'd say they are. They're
2 more similar to Kentucky-American.

3 Q. Than your other group of companies?

4 A. Than the larger group, yes.

5 MR. INGRAM:

6 I would like to now distribute, and please give
7 Connie a copy, Kentucky-American's next exhibit,
8 which is, the title, the October 2004 C.A. Turner
9 Monthly Report, consisting of four pages, which I
10 would like to have identified as Kentucky-
11 American's next exhibit, please, Your Honor.

12 CHAIRMAN GOSS:

13 Let it be marked as Exhibit 6.

14 KAWC EXHIBIT 6

15 Q. You are familiar with C.A. Turner reports; are you not?

16 A. Yes.

17 Q. And the water companies are listed on the last page;
18 are they not?

19 A. Yes.

20 Q. And I apologize for the size of the numbers, but I
21 didn't want to tamper with changing the format from the
22 way this information was delivered to me. Do you agree
23 with me that your group of small water companies,
24 consisting of five in number, in this report have, in
25 alphabetical order, the percentage of common equity of

1 36 percent for Artesian Water, 53 percent for
2 Connecticut Water Service, 46 percent for Middlesex,
3 49 percent for Pennichuck, and 45 percent for York
4 Water?

5 A. Yes.

6 Q. Would you agree with me that the average, then, of the
7 capital structure, of the common equity component of
8 the capital structures of your small water company
9 proxy group is 45.8 percent?

10 A. Subject to check, I'll accept that.

11 Q. Would you also agree with me that the allowed return on
12 equity for only four of the five companies in your
13 small water group that we have information on in this
14 report is 10.5 percent for Artesian Water, 12.7 percent
15 for Connecticut Water Service, 10.38 percent for
16 Middlesex, and 10.33 for Pennichuck?

17 A. Of the ones that are given there?

18 Q. Yes.

19 A. I mean, obviously those are dated results. If you look
20 at their actual return on equity, I think it's about
21 8.7 percent. So, I mean - but those are all dated, so,
22 you know, they're not current cases in terms of - they
23 weren't set last month.

24 Q. Is the answer to my question "Yes," according to this
25 report, my numbers that I asked you about are correct?

1 A. Yes.

2 Q. Would you agree with me that the average of those
3 returns is 10.98 percent?

4 A. Yes.

5 Q. Would you likewise agree with me that the latest return
6 available there is one in April of '03 for Artesian
7 Water with a return of 10.5 percent?

8 A. Yes. Again, that's dated, but that's the most recent
9 one.

10 Q. It's a little over a year old, a year and six months
11 old?

12 A. Yes, and the data probably came from 2002.

13 Q. Do you know whether or not Artesian Water filed on a
14 forecasted test year or a historical test year basis?

15 A. I don't know. I haven't done an Artesian case in a
16 couple of years, so I'm not sure how they do that.

17 Q. Looking again at the C.A. Turner Report, do you agree
18 with me that the percentage of common equity in the
19 capital structure for the four companies you put in
20 your large water group are 43 percent for American
21 States, 41 percent for Aqua America, 51 percent for
22 California, and 54 percent for SJW?

23 A. Yes.

24 Q. Would you likewise agree with me that the average
25 common equity component is then, of those four

1 companies, is 47.25 percent?

2 A. Yes.

3 Q. And, in both cases, the average common equity component
4 of the capital structure for your small water group and
5 your large water group is larger than the common equity
6 component for Kentucky-American Water Company in either
7 your hypothetical capital structure or Kentucky-
8 American's proposed capital structure; am I right?

9 A. Yes, and I think it's, you know, partly how these
10 numbers are computed. Not all of these compute short-
11 term debt as part of the capital structure. So
12 obviously that would change those things somewhat.

13 Q. I believe you mentioned in your testimony, did you not,
14 that the 2003 earned return on equity for the Dow Jones
15 Utilities is 12.5 percent? Perhaps if you'll look
16 at Exhibit 5, Page 3, of your testimony, you'll find
17 that.

18 A. Yeah, I think - Exhibit 5, did you say?

19 Q. I did.

20 A. Yeah, I think that's for the year 2003.

21 Q. Yes, it is.

22 A. And that, of course, they include no water utilities.

23 Q. Yes.

24 A. You know, I think the water utilities, if you look at
25 the numbers, they're somewhat smaller, lower than -

1 below that.

2 Q. Is my statement still correct?

3 A. Yes.

4 Q. Thank you. Now, in your testimony, prior to the
5 selection of a particular discounted cash flow formula
6 for your use, you talked about the stages of growth of
7 companies; did you not?

8 A. Yes.

9 Q. And I believe you characterized those stages or you
10 used a characterization - I'm not sure whether you
11 originated it or someone else did - of growth,
12 transition, and maturity; am I right?

13 A. Yes.

14 Q. And the growth stage is defined as that stage in
15 corporate life where earnings exceed dividend growth;
16 am I right?

17 A. Yes.

18 Q. And the transition stage is where dividend growth
19 exceeds earnings growth; am I right?

20 A. Yes.

21 Q. And the mature stage is where dividends and earnings
22 grow at the same rate; is that correct?

23 A. Yes, and those are general parameters.

24 Q. And I think you therefore concluded that, given the
25 regulatory environment in which Kentucky-American

1 operates, it should be considered as a mature company;
2 is that correct?

3 A. I think, yeah, any - I mean, I would say water
4 companies, gas companies, anybody who uses this type of
5 material, from an investment perspective or a
6 regulatory perspective, would presume that these
7 utilities are mature in the sense that, over time,
8 their dividends and earnings will grow at relatively
9 the same rate.

10 Q. Therefore that led you to the conclusion to use the
11 constant growth discounted cash flow formula in
12 arriving at your opinion on a recommended ROE for
13 Kentucky-American; am I right?

14 A. Yes, and I would say it's used almost universally in a
15 regulatory framework, using a constant growth DCF
16 model.

17 MR. INGRAM:

18 Your Honor, I would like to have distributed, at
19 this point, Kentucky-American's next exhibit
20 which I'd ask to be marked as Kentucky-American
21 Water Company's Exhibit No. 7.

22 KAWC EXHIBIT 7

23 CHAIRMAN GOSS:

24 Is there any objection to No. 6? I assume
25 there's not. We'll go ahead and admit that.

1 MR. INGRAM:

2 And may I move for the admission of Kentucky-
3 American's Exhibit No. 6?

4 MR. SPENARD:

5 No objection.

6 CHAIRMAN GOSS:

7 So granted.

8 KAWC EXHIBIT 6

9 Q. Would you agree with me that what you have in front of
10 you represent copies of Value Line's publication for
11 six of the water utilities you used, all dated July 30,
12 2004?

13 A. Yes.

14 Q. And, among these six companies, I want to call your
15 attention to the three that are on top and particularly
16 the analysts' projections for the increase in earnings
17 and dividends. Am I correct that, for American States
18 Water, the analysts for Value Line project earnings to
19 grow at a rate of 9.5 percent and dividends at 1.5 per-
20 cent?

21 A. Yes.

22 Q. And am I correct that, for Aqua America, the analysts
23 project earnings to grow at the rate of 9.0 percent and
24 dividends at 7.0 percent?

25 A. Yes.

1 Q. And, for California Water, the analysts project
2 earnings to grow at 11.0 percent and dividends at
3 1.0 percent?
4 A. Yes.
5 Q. So, for those three companies, certainly the only ones
6 with projections available in Value Line, their
7 earnings growth is projected to be greater than their
8 dividend growth; is it not?
9 A. Yeah, but, I mean, obviously you're not accounting for
10 the bias in those forecasts in the earnings side, which
11 is a pretty well-known phenomena, so you have to
12 account for that, and, you know, this is one shot; it's
13 not over time. If you look at the industry over time,
14 look at the dividends and the earnings, they tend to
15 grow at a relatively stable rate. At one point in
16 time, one may be different, you know. You know,
17 American States may be different than York Water, but,
18 over time, they tend to grow relatively together.
19 Q. If Kentucky-American, in your opinion, were in its
20 growth stage where earnings exceeded dividend growth,
21 would you have used a different DCF model other than
22 the constant growth one?
23 A. Well, if Kentucky-American was growing their earnings
24 at 15 to 20 percent a year, like Dell Computer, and
25 they're growing their dividends at a much slower rate,

1 I would say yes. If they're growing their earnings -
2 usually the growth model of the DCF assumes you're
3 growing your earnings 15 or 20 percent a year. If that
4 was the case, then I would say yes. You'd use a
5 different stage. You wouldn't just use a constant
6 annual growth rate. You would say, well, in the first
7 five years, maybe the growth rate would be 10 percent;
8 after that, maybe it would be 5 percent. So you would
9 just change - usually would just change in one stage or
10 another.

11 Q. In your use of the DCF formula that you used, you
12 relied upon historical payment of dividends, did you
13 not, for your proxy companies? Did you use historical
14 dividends paid?

15 A. Oh, yeah. I was just trying to understand your
16 question. I mean, I looked at historic growth rates,
17 and I think that's on Schedule - it's JRW-7, Page 2. I
18 looked at sales, earnings, dividends, book value per
19 share.

20 Q. In calculating the dividend yield for the DCF formula,
21 you used historical dividends; did you not?

22 A. Well, I used the dividend yield over the most recent
23 12 months.

24 Q. That would be historical period; wouldn't it?

25 A. Yes.

- 1 Q. Do you agree with me that investors rely on the present
2 value of expected dividends in making investment
3 decisions?
- 4 A. That's why we use the discounted cash flow model. Yes,
5 I agree with that, but, to compute the dividend yield,
6 you have to compute the current dividend or the most
7 recent dividends and divide it by the current price.
8 Now, I used the 12-month average in the spot yield
9 mainly because some of the earnings forecasts we have
10 aren't from the most recent month or two. Some of
11 those were made months ago. So I'm just trying to line
12 up the expectations of growth with the dividend yield
13 that's used in the calculation.
- 14 Q. Do you agree with me that, in making decisions,
15 investors utilize the present value of expected
16 earnings?
- 17 A. No. According to the DCF, it's the present value of
18 expected dividends and cash flows.
- 19 Q. And not expected earnings?
- 20 A. Well, dividends and cash flows come from earnings. So,
21 in a way, indirectly, earnings are involved; yes.
- 22 Q. Okay. Do you agree with me that security analysts'
23 growth rates are more accurate than forecasts based on
24 historical growth?
- 25 A. No.

1 Q. You do not?

2 A. No. I mean, I study these things. What I find is that
3 historically, you know, there's - there's not one - you
4 can't use one versus the other if you want to forecast
5 future earnings growth rates.

6 Q. Rest assured I don't study them, Dr. Woolridge. I'm
7 just asking a question. So you disagree, if I happen
8 to believe that security analysts' growth rates are
9 more accurate than forecasts based on historical
10 growth, you say I'm wrong; right? Is that correct?
11 You disagree with me?

12 A. I disagree with you to the extent if you're just making
13 that blanket statement. Yes, I'm disagreeing with
14 that.

15 Q. Are you familiar with the work of Dr. Roger Morin?

16 A. I'm familiar who Dr. Morin is. I've testified against
17 him.

18 Q. Let me read you a quote from his book on "Regulatory
19 Finance," and it's on Page 154. "Published studies in
20 the academic literature demonstrate that growth
21 forecasts made by security analysts represent an
22 appropriate source of DCF growth rates, are reasonable
23 indicators of investor expectations and are more
24 accurate than forecasts based on historical growth."
25 You disagree with that statement?

1 A. Yeah, well, obviously, if you believe that, you've
2 never heard of Eliot Spitzer and what he's been doing
3 in the last couple of years, because what Eliot Spitzer
4 found out is all these things are biased, and, I mean,
5 obviously I'm sure that book is dated long before Eliot
6 Spitzer showed up.

7 Q. I take it, then, likewise you disagree with this
8 statement of Dr. Morin: "... there is an abundance of
9 empirical research that shows the validity and
10 superiority of earnings forecasts to estimate the cost
11 of capital."

12 A. I most definitely do. I think, if you look at my
13 testimony and you read what happened around Eliot
14 Spitzer's investigations, it's clear that there's a
15 bias to those earnings forecasts and the reason is
16 because, if you work for Merrill Lynch or Goldman,
17 Sachs and you're forecasting earnings, you're helping
18 out the other side of the house, and so I disagree with
19 that.

20 Q. Did the DCF model that you used recognize quarterly
21 dividend payments or annual dividend payments?

22 A. Quarterly.

23 Q. Am I correct that your Capital Asset Pricing Model
24 suggestion to this Commission using the small water
25 company proxies you used is your basis for a recom-

1 mendation of 6.97 percent return on equity?

2 A. That's the number I got. That's obviously not the

3 number I'm recommending.

4 Q. Yes, but . . .

5 A. That's correct. I mean, the number . . .

6 Q. . . . that's what . . .

7 A. Using the Capital Asset Pricing Model given the risk

8 free rate and the beta and the expected market risk

9 premium comes up with a number of about 7 percent, and

10 I'm not recommending that number.

11 Q. Are you aware that Kentucky-American projects a debt

12 cost, in September of 2005, at 6.79 percent?

13 A. Excuse me. What's the date on that?

14 Q. September 2005, in the forecasted test year.

15 A. Yeah. I mean, that reflects embedded issues of debt

16 which have been in the capital structure historically.

17 It doesn't reflect the fact that interest rates today

18 are at a 40-year low. I mean, it doesn't reflect what

19 - their embedded debt cost rate, what's in their

20 capital structure reflects previous issues of debt

21 which were issued in the past. It doesn't reflect what

22 interests are today. You know, my numbers reflect what

23 interest rates are today.

24 Q. You anticipated a question I did not ask, so let me

25 repeat my question. My question was, are you aware

1 that Kentucky-American projects a debt cost of
2 6.79 percent for a long-term debt issuance to be
3 consummated in September of 2005?
4 A. I mean, yeah. I don't know what the source of that
5 projection is.
6 Q. Okay, but you are aware . . .
7 A. I don't know when it was made. I don't know - you
8 know, currently, long-term interest rates are - you
9 know, the 30-year rate is at 4.8 percent. I doubt
10 using a 30-year rate at 4.8 percent you would project
11 that as a long-term borrowing rate.
12 Q. Well, if that turns out to be the cost of the debt
13 issuance, a rational investor would not be willing to
14 invest in common equity that only pays 18 basis points
15 above the debt; would it?
16 A. Well, I'm not making that recommendation.
17 Q. Okay, but you agree with my assumption; no rational
18 investor would do that?
19 A. You know, I would agree with you, but, you know, the
20 numbers I'm using are based off of numbers that are
21 kind of current. The market risk premium is, you know,
22 it's the same market risk premium that the CFOs are
23 projecting over the next ten years. I mean, the
24 numbers I'm using are numbers that are current in the
25 marketplace. They aren't past or historic numbers.

1 They're looking forward and coming up with an expected
2 market risk premium and reflects what people expect of
3 the future, not what people projected 65 years ago.

4 Q. Did you add anything to your calculation for a
5 flotation adjustment for the common equity of Kentucky-
6 American?

7 A. No, I did not, and the reason is given in my testimony.
8 I asked questions about their flotation costs and they
9 said there were none.

10 Q. Just because there may not be flotation costs to the
11 subsidiary does not mean that there are not flotation
12 costs to the parent; am I correct?

13 A. And I asked that question as well.

14 Q. Are you familiar with the process in Florida in
15 recommending a range of return on equities for water
16 and wastewater companies?

17 A. No.

18 MR. INGRAM:
19 May I please have marked, Your Honor, Kentucky-
20 American Water Company's next exhibit for
21 identification purposes, which is currently
22 being distributed, please?

23 CHAIRMAN GOSS:
24 Yes, sir. We'll mark that Kentucky-American
25 Exhibit No. 8.

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CHAIRMAN GOSS:

Do you wish to formally move admission of
Exhibit 7?

MR. INGRAM:

Thank you, Your Honor. I do indeed.

CHAIRMAN GOSS:

Any objections?

MR. SPENARD:

Not on No. 7.

CHAIRMAN GOSS:

All right. Let it be entered.

Q. Dr. Woolridge, you have before you an Order of the
Public Service Commission of Florida, dated June 10,
2004; do you not?

A. Yes.

Q. And if you'll look at the back two pages, you'll see
that there is a Consummating Order which makes it
effective, as I understand the process in Florida,
dated July 2, 2004; am I right?

A. Yes.

Q. The second paragraph on Page 1 of this Order sets forth
kind of the premise for what's contained in the
Order . . .

1 MR. SPENARD:

2 Mr. Chairman?

3 CHAIRMAN GOSS:

4 Yes, sir.

5 MR. SPENARD:

6 I'd like to get a basis for the questioning.
7 First, we're not in Florida. Second, our expert
8 was not retained as an expert on Florida law or
9 Florida ratemaking. So, before we proceed any
10 further on this, I would like to have some basis
11 for the scope of the examination and the
12 relevance. We're simply not in Florida.

13 MR. INGRAM:

14 I'll be glad . . .

15 CHAIRMAN GOSS:

16 Well, that's sort of what I was asking a minute
17 ago when you were wanting all the information
18 from New Jersey, and Delaware, and these other
19 places. I was, at that time, unsure about the
20 relevance of those things to Kentucky. Now I'm
21 hearing you sort of say the same thing. I guess,
22 what is the relevance of it?

23 MR. INGRAM:

24 Your Honor, this is the methodology that the State
25 of Florida uses to produce a range of common

1 equity for water and wastewater utilities using
2 the DCF formula and the Capital Asset Pricing
3 Model. What I intend to show is that there is a
4 tremendous variance between not only the process
5 but the results used in Florida compared to this
6 witness' calculations. I think any return on
7 equity recommendation must be benchmarked with
8 respect to reasonableness and reasonableness can
9 encompass a large range of things, like what other
10 commissions are awarding, what other commissions
11 are doing, how other commissions address the
12 problem, what utilities are actually earning.
13 This witness' testimony is replete with those
14 kinds of incidents and this is one that I want to
15 acquaint him with.

16 MR. SPENARD:

17 Mr. Chairman, as a preliminary matter in that
18 we're not speaking out of both sides of our mouth
19 on this issue about the relevance of material from
20 other states, again, we do not bring in the
21 witness to testify about ratemaking in Florida and
22 we're not in Florida. They haven't sponsored
23 anything in their direct testimony to try to
24 persuade us that we need to have an examination
25 into Florida ratemaking and each jurisdiction is

1 unique in how it sets rates, and I, at this stage,
2 will object to the notion that we're going to have
3 our witness delve into the Florida ratemaking
4 process, because that's the whole legal procedures
5 about Florida. I'm not licensed to practice in
6 Florida and I don't know many people - I think,
7 from LFUCG, David Barberie may be, but I'm not,
8 and so, at this stage, for the purpose of
9 relevance I'm going to object to this line of
10 questioning.

11 CHAIRMAN GOSS:

12 Okay. Mr. Childers, Mr. Barberie, Mr. Ockerman,
13 do you have a dog in this fight?

14 MR. CHILDERS:

15 No, Your Honor.

16 MR. BARBERIE:

17 I have a general concern, but I'll just state an
18 objection for the record. I don't know how far
19 into this stuff you really want to get. I mean,
20 if he can tie it into how it's relevant to this, I
21 don't have a problem.

22 CHAIRMAN GOSS:

23 Well, that's - Mr. Wuetcher, do you have a
24 position?

25

1 MR. WUETCHER:

2 Your Honor, I could see the use of Florida's
3 methodology to the sense of gauging the witness'
4 knowledge of other types of methods for assessing
5 the cost of capital, but Commission Staff would
6 suggest that, if this is going to be an extensive
7 cross examination on this one issue, then it's
8 probably not desirable. To the extent that it's
9 only being used to discuss other methods that
10 might be used to set ratemaking, I think it would
11 be appropriate, but I don't think it would be
12 appropriate to spend a great deal of time on each
13 state's method of setting rates since the subject
14 matter of this case is how Kentucky sets it.

15 CHAIRMAN GOSS:

16 Well, I tend to agree with that. I'm going to let
17 Mr. Ingram proceed in his questioning of the
18 witness on this exhibit, but I would like for Mr.
19 Ingram to keep his questioning focused on how
20 ratemaking by this Commission would be impacted.
21 In other words, I would like for your questions of
22 the witness to go to some help that it would be to
23 this Commission and to the ratemaking obligation
24 that this Commission has, and certainly we don't
25 need a treatise on Florida ratemaking, and I would

1 assume you didn't intend to do that, and, to the
2 degree that the witness is not familiar with the
3 Florida ratemaking or this issue, certainly I'm
4 sure he can tell you that, and I think it probably
5 is also appropriate - do you intend to impeach, or
6 are you trying to impeach his methodology to some
7 degree by - well, I don't want to ask you that.
8 You don't have to answer that. Let's just keep
9 the questions focused to the issues that are
10 before the Commission. Okay?

11 MR. INGRAM:

12 I will be very brief, in addition to that, Your
13 Honor.

14 CHAIRMAN GOSS:

15 All right. So your objection is noted and over-
16 ruled with the caveat that I just gave to Mr.
17 Ingram, and we'll see how far he intends to go
18 with this. I'm not going to let it go too far.
19 Okay?

20 MR. SPENARD:

21 Yes, sir, Mr. Chairman. Thank you.

22 CHAIRMAN GOSS:

23 All right. Thank you.

24 Q. Page 2, second paragraph, sets forth the return on
25 common equity formula adopted by the Florida

1 Commission; doesn't it?

2 A. Where?

3 Q. Page 2, . . .

4 A. Yeah.

5 Q. . . . second paragraph, says "Return on Common Equity =
6 7.57% + 1.533/Equity Ratio"?

7 A. That's what they say, yeah.

8 Q. Would you agree with me, subject to check, that, if you
9 insert Kentucky-American's common equity ratio of
10 41.125 percent in that formula, you get a return on
11 common equity of 11.3 percent?

12 A. I'll agree with what you say. I have no idea why that
13 - that doesn't mean anything to me.

14 Q. Sure. Let me ask you a couple of questions about the
15 two bullet points on Page 2 and then I will quit. Does
16 the first bullet point say that the Florida Commission
17 applied the DCF model to an index of natural gas
18 utilities?

19 A. Yes.

20 Q. Does it say that they used prospective growth rates?
21 That would be in the third line of the first bullet
22 point.

23 A. It does say that, but it gives you no idea about where
24 those growth rates come from. You have no idea what
25 they're forecasting, whether it's sales growth,

1 dividend growth, earnings growth. I mean, I couldn't
2 find it in here. So really, you know, whatever
3 prospective growth is, it could just be historic
4 growth.

5 Q. Does the second bullet point, in discussing their CAPM
6 formula, state that they used the average yield on the
7 Treasury's long-term bonds?

8 A. Yes, and they don't define what long-term is.

9 Q. Dr. Woolridge, are you familiar with this Commis-
10 sion's . . .

11 MR. INGRAM:
12 May I move for the introduction of that exhibit?

13 CHAIRMAN GOSS:
14 Yes, . . .

15 MR. INGRAM:
16 Thank you.

17 CHAIRMAN GOSS:
18 . . . subject to - well, . . .

19 MR. SPENARD:
20 Subject to the Commission's ruling.

21 CHAIRMAN GOSS:
22 Subject to the previous objection?

23 MR. SPENARD:
24 Yes, sir.
25

1 CHAIRMAN GOSS:

2 Okay. Any other comment?

3 MR. WUETCHER:

4 No, sir.

5 CHAIRMAN GOSS:

6 All right. We'll go ahead and it will be
7 admitted, then.

8 KAWC EXHIBIT 8

9 Q. Did the Attorney General make you aware of this
10 Commission's recent rulings in one electric case and
11 one electric and gas case, Kentucky Utilities Company
12 and Louisville Gas and Electric Company?

13 A. Yes, they did. I mean, to the return on equity that
14 was recommended by the Commission, I believe they did.

15 Q. And what was that?

16 A. I believe the gas case was ten something, 10.3 percent
17 or something like that.

18 Q. If I read these Orders correctly, the Commission
19 allowed a return on equity of 10.5 percent for Kentucky
20 Utilities Company and 10.5 percent for the electric
21 side of LG&E. Does that comport with your
22 recollection?

23 A. Yes.

24 Q. Did you consider that information relevant in
25 formulating your opinion?

- 1 A. Well, I wasn't, obviously, a part of those proceedings.
2 I didn't read all the material that went into that
3 decision. I mean, it sounds high to me. Just given,
4 you know, what people are projecting for market returns
5 over the next ten years, it sounds very high to me.
- 6 Q. Are you aware of the Attorney General's recommendation
7 in those cases for the appropriate return on equity?
- 8 A. No.
- 9 Q. Do you consider the water business more capital
10 intensive than the electric business or the gas
11 business?
- 12 A. Yes, I agree. I think, as a general notion, it is a
13 little more capital intensive.
- 14 Q. In your mind, does the capital intensive nature of the
15 business mean there is more financial risk to the
16 shareholder?
- 17 A. No. I mean, obviously that's why you have water rate
18 cases, to get your capital investment into the rate
19 base.
- 20 Q. Would it surprise you if I told you that it took an
21 investment of three dollars and a nickel at Kentucky-
22 American Water Company in the forecasted test year to
23 produce one dollar of revenue?
- 24 A. No. Again, that doesn't comport anything about risk.
- 25 Q. And the comparable numbers for LG&E, based on their

1 Orders, would be \$2.07 for LG&E and \$1.97 for KU? Does
2 that sound like a reasonable comparison?
3 A. Yes.
4 Q. Are you aware of the projected capital needs at
5 Kentucky-American Water Company to solve its source of
6 supply problem?
7 A. Yeah. I presume that's part of the rate case.
8 Q. You don't specifically remember the size of those
9 capital needs in the future; do you?
10 A. No.
11 MR. INGRAM:
12 That's all I have at this time, Your Honor.
13 CHAIRMAN GOSS:
14 Thank you, Mr. Ingram. Mr. Childers?
15 MR. CHILDERS:
16 No, sir.
17 CHAIRMAN GOSS:
18 Mr. Barberie?
19 MR. BARBERIE:
20 No, sir.
21 CHAIRMAN GOSS:
22 Mr. Ockerman?
23 MR. OCKERMAN:
24 I have one question.
25

1 CHAIRMAN GOSS:

2 Okay. Mr. Ockerman, come on up, sir.

3 CROSS EXAMINATION

4 BY MR. OCKERMAN:

5 Q. Looking at the infamous Florida Exhibit, No. 8, below
6 the identified formula, on Page 2, are a list of four
7 basic assumptions and the first one says they are
8 basing the leverage formula depending upon an
9 assumption that business risk is similar for all water
10 and wastewater - that's what I take "WAW" to refer to -
11 water and wastewater utilities. Isn't it the case that
12 Kentucky-American is generally a water utility and not
13 a wastewater utility?

14 A. Yes.

15 Q. So it could be that the underlying assumption behind
16 that formula is inapplicable?

17 A. Yes. Well, I think there are a lot of things about
18 that formula. You'd have to get behind those numbers
19 before you - I mean, I'm not aware of the proceedings
20 and what went into determining these, but to just throw
21 those numbers out without any support of the studies
22 that was used to determine them I don't think it's
23 really relevant.

24 Q. Thank you.

25

1 CHAIRMAN GOSS:

2 Mr. Wuetcher?

3 MR. WUETCHER:

4 Thank you, Your Honor.

5 CROSS EXAMINATION

6 BY MR. WUETCHER:

7 Q. Good afternoon, Dr. Woolridge.

8 A. Good afternoon.

9 Q. Your original testimony was filed in August of 2004.
10 Has anything occurred since that time that would revise
11 your recommendation?

12 A. No. I think interest rates - again, the most rule I
13 base off is off the 10-year rate. The 10-year rate has
14 been between 10.0 and 10.2 percent. I used 10.5 per-
15 cent in my testimony as a base 10-year rate given the
16 recent range, and that sort of thing. So given that
17 interest rates - short-term rates have gone up; long-
18 term rates really haven't. I think it's because of
19 concerns about the growth in the economy, and so, no, I
20 would say there's nothing. The interest rates, there
21 hasn't been a significant change in interest rates that
22 would cause me to revise anything.

23 Q. Okay. There's been some confusion over whether or not
24 Kentucky-American is proposing the Economic Development
25 Tariff and its Emergency Pricing Tariff, but let's

1 assume for the moment that the company is proposing to
2 implement either one or both of these tariffs. Would
3 either of these new tariffs affect the recommendation
4 that you proposed?

5 A. No. It's tough to say about individual tariffs because
6 different commissions, different states, have different
7 things embedded into their decisions, and it's almost
8 like Dr. Vander Weide and myself kind of look at these
9 as kind of all else equal, and it's tough to identify
10 something specific as that to say if that changes the
11 risk and therefore the potential return of that
12 particular element. No, I haven't studied that. Dr.
13 Vander Weide has not either. So I don't know if you
14 could say that one element would cause risk to change
15 enough such that you would change the return recom-
16 mendation for this company versus, say, a group of
17 publicly-held companies.

18 Q. So the answer is "No"?

19 A. No. I'm sorry for the long explanation.

20 Q. That's okay. I appreciate the elaboration. I just
21 wanted to make sure I understood it. Do you have a
22 copy of Kentucky-American's Response to Lexington-
23 Fayette Urban County Government's Data Request 1,
24 Item 15?

25 A. No.

1 MR. SPENARD:

2 1-15?

3 MR. WUETCHER:

4 I'm sorry. Yes. It's Lexington-Fayette Urban
5 County Government's First Data Request, Item 15.

6 MR. SPENARD:

7 To state rate of return?

8 MR. WUETCHER:

9 Yes. There's an attachment, Page 1 of 1.

10 Q. Do you have that, sir? That should be a list of the
11 return on equity awards for Kentucky-American (sic)
12 (Court Reporter's Note: American) Water Works
13 subsidiaries.

14 A. Yes, I see that now.

15 Q. Okay, and there are eight awards during 2004 ranging
16 from 7.00 percent in West Virginia to 10.67 percent in
17 Hawaii and Pennsylvania?

18 A. Yes.

19 Q. Okay. Your recommendation of 8.75 percent is at least
20 100 basis points below all the other awards except for
21 West Virginia's award of 7.00 percent. You've
22 explained in your testimony why you recommended 8.75,
23 but can you discuss why Kentucky-American is so
24 different from the other states that it would need a
25 lower rate of return than, say, the subsidiary that's

1 operating in Virginia?
2 A. Yeah. I can explain why I think that is. If you look
3 in terms of how people look at these cost rates, in the
4 last two years or so, if you look at the academic
5 literature, you look at what investment banks are
6 doing, you look at the consulting companies, more and
7 more, when they're looking at return premiums required,
8 they're looking at expected return premiums, and, more
9 and more, over the last two to three years, there's
10 been this research that says, look, historic risk
11 premiums like we get when we look at historic stock
12 returns versus bond returns are up here. If you look
13 at expected return premiums, they're down here, like I
14 put in my testimony the survey of CFOs, which shows a
15 3.8 percent expected market risk premium. I look at
16 the Philadelphia Fed Survey, they have a 2.5 percent
17 expected market risk premium. So historically there's
18 been a risk premium like this; expected-wise, it's down
19 here, and I think what happens is, more and more,
20 people are recognizing that capital costs are at a
21 40-year low, you know. The 10-year rate has been
22 around 4 percent. The last time it was 4 percent was
23 in 1964. It's tough to get people in the mindset that
24 not only do you have low interest rates, you also have
25 a low expected market risk premium that people believe

1 in and you also have a change in the tax law last year,
2 and, as a result, I think, in most of the regulatory
3 community, there's been this idea of gradualism. You
4 don't suddenly adjust dramatically to this recognition
5 that capital costs are low; it's a gradual approach to
6 the fact that, yeah, capital costs are at a 40-year low
7 and, more and more, decisions made by commissions are
8 reflecting this.

9 Q. So if I understand you correctly, then, the difference
10 is not between the operating companies themselves but
11 with the attitudes of the state regulatory commissions?

12 A. Yes. I think there's a belief in gradualism. In other
13 words, you don't suddenly recognize that capital costs
14 are at a 40-year low; it happens gradually, and, as,
15 more and more, the investment community recognizes that
16 capital costs are low, that equity costs are low - I
17 mean, like I had an expected return on the market over
18 the next ten years of about 8 percent. Well, if you
19 look at a lot of the literature, like CFOs, and others,
20 recognize that's what we should expect. I mean, the
21 bad news means that 401(k's) aren't going to grow
22 as fast as we would like them to, but, you know, it's
23 not that 10 or 12 percent that historically we've seen
24 on an expected basis. Because stock prices are high
25 relative to dividends and earnings, interest rates are

1 low, as a result, the expected return on the market is
2 low, and so, if we go from this point looking forward,
3 we say what is the expected return on Kentucky-
4 American, it's low compared to what we're used to
5 seeing.

6 Q. Okay, and I just want to make clear, because I'm
7 trying to follow you, but, as you stated that, you
8 keep on making reference to analysts. The major
9 factor, all you're talking about is the acceptance
10 of utility regulators to this new lower interest
11 environment?

12 A. And lower required return element; yes.

13 Q. Okay. If you would turn to Page 7 of your direct
14 testimony and Exhibit JRW-2, there you discuss the
15 reduced return requirements of investors as a result of
16 the Jobs and Growth Tax Relief Reconciliation Act of
17 2003, a tax cut for dividends and capital gains.
18 Panel C of the exhibit shows how an investor would
19 accept the same post-tax return after the tax cut went
20 into effect. Is that a correct characterization of
21 both your testimony and the exhibit?

22 A. Yes.

23 Q. Okay. Would it be just as likely that an investor
24 would expect the tax cut to increase the after-tax
25

1 return instead of adjusting his pretax expectations?
2 A. No.
3 Q. Okay. Why is that?
4 A. Because investors care about taxes. That's why we have
5 401(k's). That's why we have IRAs. That's why
6 municipal bonds have lower rates than non-municipal and
7 Treasury bonds. Investors care about their after-tax
8 return. Now, in the exhibit, I say this differential -
9 and the reason - what I'm trying to explain here is why
10 it is, in terms of thinking about why required returns
11 are lower, one reason is last year we changed the tax
12 law. Utilities stocks tend to be owned mostly by
13 individuals. They're subject to personal taxation.
14 This impact could be as high as 100 basis points,
15 depending on a couple of different factors, in terms of
16 how it lowers the pretax required return because the
17 after-tax return is higher because you've cut the
18 dividend tax in half for an average investor, you've
19 cut the capital gains tax by 5 percentage points, and,
20 as a result, what the investor gets to keep after
21 taxes, we all know we care about - that's what we care
22 about. It's not pretax; it's after-tax.
23 Q. If you would turn to JRW-7, Pages 1 and 2, in your
24 testimony, you stated that you used the average of the
25 12-month and August 2004 dividend yields to develop the

1 dividend yield used in your DCF model. Now, to make
2 sure we understand exactly how you achieved your
3 dividend yield for the small water group, did you
4 average the 3.1 percent 12-month mean with the August
5 3.5 percent mean?

6 A. Yes.

7 Q. Okay, and, for the larger group, did you average the
8 3.3 percent 12-month mean with the August 3.5 percent
9 mean?

10 A. Yes.

11 Q. Since you already had a 12-month average, why was it
12 necessary to average in one of the months already
13 included in the 12-month average?

14 A. Mainly because to give weight to what the current -
15 give more weight to what the current dividend yield is,
16 but also I used the 12-month because a lot of these
17 expectations of growth we're deriving come not from
18 this month; they were derived over the previous
19 12 months. So that's why I used both the 12-month and
20 the current rate.

21 Q. Is that type of averaging common?

22 A. Yes.

23 Q. Could you give us some examples of where that averaging
24 is used?

25 A. Oh, I mean, where I see it is mostly in regulatory

1 ratemaking.

2 Q. Well, could you point to, I guess, some other - either

3 to some regulatory decision or to some other witness

4 who has testified before a regulatory commission that

5 also uses this methodology?

6 A. I don't know. I use it. I know we just had a decision

7 in Ohio where they liked - they used my approach, and

8 it's listed in my bio. It's a TELRIC case, SBC. But,

9 again, it's to reflect the fact, first of all, to

10 reflect what the current dividend yield is but also the

11 fact that a lot of these projections of growth have

12 been made over the last year or so. It's not like they

13 all came out today, kind of they came out over a period

14 of time.

15 Q. Okay. If you would turn to JRW-7, Page 3, and the

16 Attorney General's Response to the Commission's First

17 Set of Data Requests, Item 17c.(2).

18 A. Okay.

19 Q. Okay. The exhibit shows historic growth rate measures

20 used in your DCF analysis; is that correct?

21 A. Yes.

22 Q. Okay. There are several negative growth rates in

23 this exhibit. I think you indicated in your Response

24 to Item 17 that, "Negative growth rates are one

25 outcome that investors must deal with"; is that

1 correct?

2 A. Yes.

3 Q. In your opinion, would investors expect to see negative
4 growth rates over a period as long as three years much
5 less ten years?

6 A. Over three years?

7 Q. Yes, sir.

8 A. I mean, that's one possible outcome, yeah. I mean,
9 these are really - we're dealing with an expectation of
10 the future. There's a distribution there. There's a
11 mean. There's a high number; there's a low number. It
12 deals with the distribution of expected outcomes. Some
13 of them could be negative. You know, one of those may
14 be Enron out there; who knows, and that's got to be
15 built into the expectation. If you chop off the bottom
16 of the distribution, if you eliminate the Enrons of the
17 world, then your mean, and median, and mode are going
18 to be too high.

19 Q. Okay. In your DCF analysis, you made an adjustment to
20 the dividend yield to account for the difference in
21 using quarterly versus annual growth rates on the
22 dividend yield and also applying the cost of equity to
23 a future rate base. Could you explain how your method
24 better addresses this problem than Dr. Vander Weide's
25 quarterly DCF method?

1 A. You know, conceptually, the way you should do this is
2 you take the next quarter's dividend. So here we are
3 at this quarter. You take the next quarter's dividend
4 and multiply it by four. According to Gordon who
5 developed this, this is the way it should work. The
6 trouble is companies don't always increase their
7 dividend in the next quarter. It may be two or three
8 quarters out. So what I've done is taken one-half the
9 growth rate, recognize part of the time companies will
10 be increasing their dividend over the next quarter,
11 probably three-quarters of the time it's going to be
12 some other quarter in the future. So, conceptually,
13 according to Myron Gordon who developed this, you'd
14 take the next quarter's dividend and multiply it by
15 four, but we know that most companies increase their
16 dividend one quarter during the year. So their annual
17 dividend goes up from, say, 10 cents a share to
18 12 cents a share on a quarterly basis, but they only do
19 that during one quarter. They don't increase it every
20 individual quarter, and so that's why I did that, to
21 capture the fact that the next quarter may be the one;
22 it may not be the one. So you take that growth rate to
23 reflect that. What I also said was the fact that my
24 approach is conservative because there are elements of,
25

1 in a forward-looking ratemaking context, there are
2 elements that go into rate base which are coming on
3 line in the current year. Well, the way the DCF does
4 it says assuming today that we take that rate base in
5 the cost of capital. They don't reflect the growth
6 that occurs over the coming year. So I think my
7 approach is conservative in that context.

8 Q. Turn to Page 15 of your testimony and JRW-6 and Page 1
9 of JRW-8.

10 A. Excuse me. What page in my testimony?

11 Q. I've got Page 15.

12 A. Okay.

13 Q. But I'm going to be referring primarily to JRW-6,
14 Exhibit JRW-6.

15 A. Uh-huh. Yes.

16 Q. Okay. JRW - and also to Page 1 of your Exhibit 8.

17 A. Yes.

18 Q. JRW-6 shows that the betas of water utilities are
19 close to the lowest in the industries listed on
20 this schedule, averaging about .57; would that be
21 correct?

22 A. Yes.

23 Q. Okay. In JRW-8, you used betas of .65 for the small
24 water companies and .66 for the large water companies
25 in your CAPM analysis. Why do your proxy companies

1 have a higher beta than the average of the industry?
2 A. Well, the industry has 16 firms, according to the Value
3 Line. Now, one thing about their industry, which is
4 water utilities, it's a little more diverse in terms of
5 anybody who's related to the water utility industry.
6 So they apparently are a little bit higher. The
7 industry as a group is higher than the water utilities
8 I'm using here, but, even at .65, of the 101 industries
9 listed there, they're in the bottom, you know. That
10 would indicate the capital costs for water utilities
11 are in the bottom 10 percent or so of all industries.
12 Q. Okay. I want to refer to the AG's Response to
13 Commission Staff's First Information Request, Item 19b.
14 MR. HOWARD:
15 "b" as in "boy"?
16 MR. WUETCHER:
17 "b" as in "boy" or "bravo."
18 MR. HOWARD:
19 I'm sorry, Mr. Military.
20 Q. Do you have that, sir?
21 A. Yes.
22 Q. Okay. You indicated that 10.3 appeared to be excessive
23 for a water company because interest rates have
24 declined and, all else being equal, would lower
25 required return on equity. The Federal Reserve has

1 increased interest rates twice since July of 2004.
2 Would this indicate that the required return on equity
3 has increased?
4 A. No.
5 Q. Why not?
6 A. Because those are short-term interest rates.
7 Q. Okay. Would you turn to the AG's Response to the First
8 Commission Staff's Information Requests, Item 17a.?
9 Some of the data in that Response is missing. Could
10 you supply a complete copy? Do you see what I mean by
11 missing data?
12 A. No, I don't. Maybe I have the wrong - is this 17a.?
13 Q. It's 17a.; yes, sir.
14 A. I'm sorry. What's missing?
15 Q. Hold on just - let me give you the correct page. If
16 you'll turn back 15 pages, I think the 16th page,
17 there's a chart with five columns.
18 MR. SPENARD:
19 Is this the Response or is this his testimony?
20 MR. WUETCHER:
21 Well, I believe this is his . . .
22 CHAIRMAN GOSS:
23 Mr. Wuetcher, why don't you get up and walk over
24 to where the witness is seated and Mr. Spenard
25 is and maybe you all can get on the same page,

1 both literally and figuratively.

2 MR. WUETCHER:

3 That would be the easy way of doing it, sir.

4 (CONFERRING AT WITNESS STAND)

5 MR. WUETCHER:

6 Your Honor, based upon our conference at the

7 witness stand, the witness is going to check his

8 Response and determine the reason for the missing

9 data and then supply us, if there's no data to be

10 supplied, then just to supply us with the reason

11 why there's no data.

12 CHAIRMAN GOSS:

13 I'll have to think about that one just a minute,

14 Mr. Wuetcher.

15 MR. WUETCHER:

16 It's been a long day, Your Honor.

17 CHAIRMAN GOSS:

18 That's fine.

19 MR. HOWARD:

20 I think we understand, Mr. Chairman.

21 CHAIRMAN GOSS:

22 All right. I'm glad you do.

23 MR. WUETCHER:

24 I'm sure anyone reading the record will know.

25 Q. Dr. Woolridge, if you would turn to your Exhibit 7 of

1 your testimony, Page 5, . . .

2 A. Yes.

3 Q. Okay. The schedule of that exhibit shows the growth

4 rate measures for the DCF analysis and shows analysts'

5 projected earnings per share estimates.

6 A. Yes.

7 Q. Would the lack of analysts' estimates for three of the

8 companies indicate that there is not a sufficient

9 number of water companies covered by analysts to

10 perform a meaningful analysis?

11 A. No. I mean, it gives you an idea of what's available

12 in terms of the projections. Certainly it suggests

13 that some of those are - you know, I weight both, look

14 at the historic numbers as well as the projected

15 numbers. I recognize that most of Wall Street knows

16 that these projected numbers are biased upwards to

17 begin with, and so, I mean, obviously you'd like to

18 have more data points, but they give you an indication

19 of what expectations may be.

20 MR. WUETCHER:

21 I believe that's all we have. Thank you.

22 A. You're welcome.

23 CHAIRMAN GOSS:

24 Okay. Do you have redirect, Mr. Spenard?

25

1 MR. SPENARD:

2 Yes, sir, I have a few.

3 CHAIRMAN GOSS:

4 Okay.

5 MR. SPENARD:

6 Okay.

7 REDIRECT EXAMINATION

8 BY MR. SPENARD:

9 Q. Will you turn back to Kentucky-American's Hearing
10 Exhibit - I believe it's Exhibit 6. This was the C.A.
11 Turner Monthly Report.

12 A. Yes.

13 Q. Are you aware of whether or not Artesian Water Company
14 is currently in a rate case with briefs due in December
15 2004?

16 A. No, I'm not aware of that.

17 Q. Okay. In terms of the Middlesex Water Company,
18 it shows a return of 10.38 percent. Do you see
19 that?

20 A. Yes.

21 Q. Do you know if Middlesex has had a more recent rate
22 case?

23 A. No.

24 Q. You don't know, or no, they have not?

25 A. I do not know.

1 Q. Okay. Is Middlesex located in New Jersey?
2 A. Yes.
3 Q. Okay. Going back to this exhibit, does this exhibit
4 show three New Jersey cases? I'm sorry. Going back to
5 the very first exhibit that Kentucky-American provided,
6 and this was the two slides from the PowerPoint
7 presentation, does this exhibit show three New Jersey
8 cases?
9 A. Yes.
10 Q. And the range of these returns from 9.5 percent to
11 9.75 percent, and the three cases being Jersey
12 Central Power & Light Company, the Public Service
13 Electric & Gas Company, and then the Rockland Electric?
14 CHAIRMAN GOSS:
15 He's just asking you if the range is between
16 9.5 and 9.75.
17 A. Yes. Oh, I'm sorry. I didn't know it was a question.
18 Yes. I see that; yes.
19 Q. Okay. All right. Do you know what returns on equity
20 have been approved in New Jersey cases in the year
21 2004?
22 A. No.
23 Q. Okay. You were asked a question in the data request
24 regarding return on equity in a Kentucky gas case?
25 A. Yes.

1 Q. Would you suspect that all gas utilities in Kentucky
2 would have the same return on equity, or could there
3 be differences between the respective gas utilities
4 in terms of their risk and their various situations?
5 A. Yeah, I mean, there could be; yes. I haven't looked at
6 that.
7 Q. Okay. Does Kentucky-American have the right to file
8 for rate relief?
9 A. Yes.
10 Q. Okay, and Kentucky-American uses a forward-looking test
11 period?
12 A. Yes.
13 MR. SPENARD:
14 I think that's it.
15 CHAIRMAN GOSS:
16 Anything further limited to the scope? Any of
17 you three gentlemen? Mr. Wuetcher?
18 MR. WUETCHER:
19 I have one question. It was something that Mr.
20 Ingram asked at the very beginning.
21 RE CROSS EXAMINATION
22 BY MR. WUETCHER:
23 Q. This was a presentation that you were to make at a
24 conference in Atlanta last year?
25 A. Yes. It's actually - I just talked about the

1 implications of the tax act. I didn't talk about the
2 rest of this material.
3 Q. Okay. So you did make the presentation? This material
4 just . . .
5 A. I talked about the implications of the tax act; not
6 this material.
7 Q. Okay.
8 A. I think this was sitting around someplace, . . .
9 Q. Okay.
10 A. . . . but they asked me to focus on the implications of
11 the tax act on the cost of capital.
12 Q. Thank you.
13 MR. WUETCHER:
14 That's all we have.
15 CHAIRMAN GOSS:
16 Okay. Anything further Mr. Spenard?
17 MR. SPENARD:
18 No, sir, and, Mr. Chairman, I was just going to
19 ask, if there's nothing further, I'd ask that this
20 witness be excused.
21 CHAIRMAN GOSS:
22 Any objection?
23 MR. WUETCHER:
24 No, sir.
25

1 CHAIRMAN GOSS:
2 Okay. Dr. Woolridge, thank you very much. We
3 hope you can make your plane or whatever it is you
4 need to get to. Thank you for coming.
5 DR. WOOLRIDGE:
6 Thank you.
7 CHAIRMAN GOSS:
8 We appreciate it.
9 DR. WOOLRIDGE:
10 Thank you.
11 CHAIRMAN GOSS:
12 And he may be excused.
13 MR. SPENARD:
14 Yes, sir, and to state again that the Office
15 of the Attorney General appreciates the
16 graciousness of taking Dr. Woolridge out of order.
17 DR. WOOLRIDGE:
18 Yeah. Thank you.
19 CHAIRMAN GOSS:
20 Thank you, Mr. Spenard. Okay. We're at a good
21 breaking point here. Let's take about a ten-
22 minute break this time. We'll come back at ten
23 after three.
24 OFF THE RECORD
25

1 CHAIRMAN GOSS:
2 All right. Everyone, be seated. Please be
3 seated. Thank you. Okay. Mr. Ingram, who do we
4 have?
5 MR. INGRAM:
6 We have Michael Miller, Your Honor.
7 CHAIRMAN GOSS:
8 Mr. Miller.
9 MR. INGRAM:
10 No reflection on him intended, but I'm getting
11 close to the bottom of the barrel. I have two
12 after him.
13 CHAIRMAN GOSS:
14 We are on the record, aren't we?
15 MR. MILLER:
16 I'd just as soon not read that on the record.
17 WITNESS SWORN
18 The witness, MICHAEL A. MILLER, after having been
19 first duly sworn, testified as follows:
20 DIRECT EXAMINATION
21 BY MR. INGRAM:
22 Q. Would you state your name, please?
23 A. My name is Michael A. Miller.
24 Q. What is your business address?
25 A. P.O. Box 1906, 1600 Pennsylvania Avenue, Charleston,

1 West Virginia 25327.

2 Q. Who do you work for?

3 A. American Water Works Service Company.

4 Q. How long have you been working in the American system?

5 A. All my life. No, 28 years, Mr. Ingram.

6 Q. Do you provide services to Kentucky-American Water

7 Company?

8 A. Yes, sir, I do, and I have through the majority of

9 those years.

10 Q. And you have in this rate case?

11 A. I have, sir.

12 Q. Have you filed direct and rebuttal testimony?

13 A. Yes, I have, sir.

14 Q. If I asked you the questions contained therein today,

15 how many corrections would you give me?

16 A. I have just a couple of corrections, Mr. Ingram.

17 Q. All right, sir.

18 A. The first one is on my direct testimony, Page 24, on

19 Line 10. It gives a number for the ongoing security

20 expenses of \$143,194. I believe in our data request we

21 updated that, and it was mentioned this morning, to

22 \$134,412.

23 Q. Yes, sir.

24 A. On Page 30 of my direct, Line 7, again, that number

25 needs to be changed to "\$134,412," and, again, on

1 Page 31, Line 10, the "\$143,194" needs to be
2 "\$134,412," and, on Exhibit, to my direct testimony,
3 Exhibit MAM-5, Page 1 of 5, under each of the "Customer
4 Care Savings," "Other Customer Accounting Savings,"
5 "Finance/Accounting Savings," it indicates that that is
6 "Exhibit MAM-2." It should be "MAM-5" in each
7 instance. In the "Other Finance/Accounting Savings,"
8 there should be "page 5 of 5" after that, and one other
9 area in my rebuttal testimony, Exhibit 6, in the
10 "Forecasted Period" column, under "Number of Customers:
11 12-Month Average," the number should be "102,069." For
12 "Commercial," it should be "8,282," and for "Other
13 Water Utilities," it should be "7." The "Total" would
14 be "110,897," I believe, if I can read my writing.

15 CHAIRMAN GOSS:

16 Mr. Miller, would you go over those again for me?

17 You went too fast for me.

18 A. Sorry, sir.

19 CHAIRMAN GOSS:

20 That last one, MAM-6.

21 A. Okay. On the "Forecasted Period" column, which is the
22 third one in from the left - or from the right - I'm
23 sorry - . . .

24 CHAIRMAN GOSS:

25 Okay.

1 A. . . . the number of residential customers there is
2 "103,304." That should be "102,069," . . .

3 CHAIRMAN GOSS:
4 Okay.

5 A. . . . and, where it says "8,341" for "Commercial," that
6 should be "8,282," and where it says "Other Water
7 Utilities," it says "9," that should be "7," and the
8 "Total" of the 12-month average should be "110,897."

9 CHAIRMAN GOSS:
10 Okay. Thank you.

11 A. On the "End of Period" section, it says "9" other water
12 utility customers in the "Forecasted Period." That
13 should be "7," and the "Total" would now be "112,141."
14 In the "Average Consumption per Customer" section in
15 the "Forecasted Period" column, the "Residential"
16 number should be "58.110." The "Commercial" should be
17 "493.820," and the "Miscellaneous" should be "53.192."
18 That's all the changes I know about, Mr. Ingram.

19 Q. Could I suggest to you, Mr. Miller, that maybe you
20 can't read your numbers as well as . . .

21 A. Is it 147 or 197?

22 Q. The addition I make with my calculator is 110,358.

23 A. Let me check it one more time.

24 Q. Please do. Let's get the record straight.

25 A. 110,847.

1 MR. BARBERIE:

2 Could I request that they provide a supplemental
3 exhibit for that particular . . .

4 MR. INGRAM:

5 That's appropriate, and we will do it. Yes.
6 Thank you.

7 MR. BARBERIE:

8 Thank you.

9 MR. INGRAM:

10 I have no further questions at this time.

11 CHAIRMAN GOSS:

12 All right. Thank you. Mr. Spenard?

13 MR. SPENARD:

14 Yes, sir.

15 CROSS EXAMINATION

16 BY MR. SPENARD:

17 Q. Good afternoon, Mr. Miller.

18 A. How are you, Mr. Spenard?

19 Q. I'm fine. Kentucky-American made the decision to use a
20 forward-looking test period in this case; is that
21 correct?

22 A. Yes, sir, as we have since, I think, the '92 rate case;
23 yes, sir.

24 Q. Okay. Are you the person who made that decision?

25 A. Yes, sir.

- 1 Q. In how many other jurisdictions where there are
2 American Water Works companies is a forecast test
3 period utilized?
- 4 A. Sir, I don't know the answer to that on each and every
5 American Water Works company. In the companies where I
6 have appeared in regards to American Water Works,
7 Virginia, West Virginia, Kentucky, Tennessee and
8 Maryland, Tennessee uses a forecasted test year.
9 Virginia-American generally uses an historical test
10 year. However, you adjust that for known and
11 measurable changes, and they also recognize CWIP
12 through the time of the hearing. I don't know of
13 anybody that just takes a straight historical test
14 year. West-Virginia, we file an historical test year,
15 but it's updated for all known and measurable changes
16 and it's also adjusted through the rate year, which
17 would be basically a fully forecasted rate base.
- 18 Q. And with regard to Maryland?
- 19 A. It's been a long time since we filed Maryland, but it's
20 a historical test year adjusted for known and
21 measurable.
- 22 Q. Prior to Kentucky-American's rate case in 1992, the
23 company used an historic test period. Did the
24 Commission allow known and measurable changes?
- 25 A. I'm sure they did. I don't know of any commission that

1 doesn't try to set rates, during the period that the
2 rates from the case are going to be effective, taking
3 into account known and measurable changes, trying to
4 determine what the costs are going to be in that rate
5 year.

6 Q. Okay. Do you believe that the utility receives a
7 benefit by being able to file a rate case using a
8 forecasted test period?

9 A. I don't know that I fully understand that question, Mr.
10 Spenard.

11 Q. Let's rephrase it. Do you believe that the utility,
12 Kentucky-American, receives a benefit by being able to
13 file a rate case using a forward-looking test period?

14 A. I don't think I would classify it as a benefit or a
15 detriment either one. I think what a forecasted test
16 year is intended to do is what you do in an historical
17 test year and that is to determine what are the costs
18 going to be in the period that rates are being set in
19 order to permit the company an opportunity to achieve
20 an ROE that's authorized by the Commission and, in
21 doing so, setting fair and just rates. A forecasted
22 test year is just one method of doing that. There are
23 others.

24 Q. And, in Kentucky, Kentucky-American has the option of
25 choosing between an historic test period and a

- 1 forecasted test period; is that correct?
- 2 A. I believe that we have that option, but I believe we
3 also, if we revert back to the historical test year, we
4 must stay there; that we're not - I don't think we're
5 freely able to just decide in any particular case which
6 one we'll do.
- 7 Q. Okay. But, at some stage, Kentucky-American made the
8 election to use a forecasted test period and they felt
9 that it was more beneficial than using an historic test
10 period.
- 11 A. It is a method - yes. We think the forecasted test
12 year is the best way to look at what the costs are
13 going to be in the period that rates will be
14 established in any rate case. We think that's the best
15 of all methods. To define it as some kind of benefit,
16 I don't know that I agree with that. It is a method of
17 determining fair and just rates in this case and we
18 think it's the proper way to do it.
- 19 Q. Okay. On Page 12 of your testimony, you discuss the
20 Service Company reorganization. Would you turn to
21 Page 12?
- 22 A. Certainly, sir. Give me just one second.
- 23 Q. Okay.
- 24 A. I gotcha.
- 25 Q. Okay. Now, can you update us on the status of these

1 activities?

2 A. Certainly. Where we are at right now with the
3 reorganization is that, as has been stated here earlier
4 today, I think, by Ms. Bridwell, we've finished the
5 formal Phase I, II, III, and IV of that reorganization
6 process. There have been some shifts. We've generally
7 described it in our testimony about the functional
8 alignments of the various functions, such as
9 distribution, or we call it network services these
10 days, production, water quality, with more aligned with
11 those functionalities through the Region Office in
12 order that we can share best practices and efficiencies
13 and things like that through our organization by
14 sharing of those best practices and ideas. There are -
15 there have been some people that have left the company
16 because of that. I think we're basically settled into
17 the organization that we described in our data requests
18 right now. There are some vacancies to be filled
19 across even the companies that I work with closely.
20 We're pursuing doing that actively in all places right
21 now. I think that's a summary of where we're at, if it
22 answers your question, Mr. Spenard.

23 Q. Yes, sir. That's fine. Does the company have any
24 estimate of the impact of these reorganization
25 activities on its revenue requirement?

1 A. In regards to Kentucky-American?
2 Q. Yes, sir.
3 A. I think we heard Ms. Bridwell this morning mention that
4 we had three people that had moved to the Service
5 Company that had formerly been on Kentucky-American's
6 payroll. Well, two people - I'm sorry - Ms. Bridwell
7 and Mr. Svindland, and basically that movement over to
8 the Service Company has no impact on Kentucky-
9 American's revenue requirement. As far as the
10 operation and maintenance labor expense, we asked for
11 it in a forecasted test year since they were 100 per-
12 cent capitalized. To the extent that Ms. Bridwell or
13 Mr. Svindland charged time to maybe other companies
14 within the region, there's going to have to be an
15 influx of at least FTE hours and salary to offset that
16 in management fees from other people that might take
17 those functions now in the Southeast Region. So the
18 answer is that I think there's very little impact on
19 the revenue requirement that we ask for in this case.
20 Q. So, for example, with regard to the implementation of
21 best practices in providing customer accounting and
22 billing, your reorganization activities have no impact
23 on the revenue requirement for Kentucky-American?
24 A. You asked - I think your question was in regards to the
25 revenue requirement requested in this case. We have

1 fully embedded the savings from the Customer Care
2 Center transition to the National Care Center, Customer
3 Care Center. We've fully embedded that in this rate
4 case, as was identified on my exhibit to my direct
5 testimony, MAM-5. I think those, a combination of that
6 and the Shared Services in the Southeast Region that we
7 had done over time had produced a savings of about
8 \$232,000 which are embedded in this case. So it
9 doesn't affect the impact we requested because those
10 savings are already there.

11 Q. Thank you. With regard to the deferred accounting
12 treatment, let's talk about the deferred accounting
13 treatment for Service Company reorganization transition
14 costs and Customer Care Center costs. Are you familiar
15 with this topic?

16 A. Yes, sir. I've prepared and submitted testimony in
17 every state in our region that's dealt with this
18 subject to this point and I've been involved with the
19 actual transition itself, so very familiar.

20 Q. Okay. The company sought deferred accounting treatment
21 for these costs; is that correct?

22 A. We did. I think it's fully covered in a number of
23 letters that are attached as exhibits to my direct
24 testimony. I think that was the first that - you're
25 talking about the transition to Shared Services and the

1 Customer Care Center now; right?

2 A. Yes, sir. Yes, I think those were both included in a
3 request that we made upon the Commission on September
4 6, 2001.

5 Q. Okay.

6 A. Initially did that.

7 Q. Okay. With regard to this treatment, the deferred
8 accounting treatment has not been obtained; is that
9 correct?

10 A. No, sir. I mean, as far as in an affirmative yes or
11 no, we still do not have an affirmative yes or no, and
12 I think it gets back to an understanding of what the
13 company was really asking from the very first time that
14 it made this request, that these deferrals should be
15 addressed in the context of a general rate filing, and
16 that's where we're at now and that's what we're asking
17 the Commission to do, is to recognize that the company
18 has had these deferred costs, they have generated
19 savings, and we're asking for an amortization of that.
20 I would just add one other thing to that. In regards
21 to both the Call Center and Shared Services, because
22 there were savings once we implemented those two
23 reorganization and service improvement-related
24 projects, we did go ahead and start amortizing the
25 deferred costs to the extent there were savings so that

1 the company would not have a positive impact on its
2 bottom line because of those savings and, at the same
3 time, ask for future recovery of deferrals. So we
4 tried to - not tried; we did do what we interpret
5 FAS 71 said we should do in regards to those until the
6 Commission can determine the future position of those
7 deferrals going forward.

8 Q. Well, let's break that down into smaller parts. The
9 first part is deferred accounting treatment, seeking
10 the approval for deferred accounting treatment, the
11 second part being the rate treatment. Under the
12 assumption that deferred accounting treatment is
13 approved, does that mean - does that approval for the
14 treatment mean that the recovery of the costs are
15 automatically ensured by rates?

16 A. Absolutely not, and I think we clearly indicated that
17 in all of our correspondence regarding that, that we
18 weren't seeking rate recovery when we requested
19 accounting deferral, that any rate recovery issues
20 would have to be dealt with in a general rate case. So
21 we were only seeking the permission to defer it for
22 accounting purposes to be handled in the next rate
23 case.

24 Q. Okay. Well, what standards do you think the Commission
25 should use in deciding whether or not to approve a

1 request for deferred accounting treatment?

2 A. What standards?

3 Q. Yes, sir.

4 A. Well, I mean, the first standard that I think it needs
5 to consider would be FAS 71 and how those items of
6 deferral are to be treated. I think we've been
7 consistent with FAS 71 and beginning to amortize those
8 deferrals to the extent there were savings in the
9 interim period between rate filings. I think the
10 second principle that I can think of, or standard, if
11 you will, is the matching principle that we talk about
12 in rates a lot and that is that, now that we're in a
13 general rate filing, those savings that were identified
14 on my Direct Exhibit MAM-5 related to those two items
15 are now being fully embedded in rates and passed to the
16 ratepayers in this case, and, in order to properly
17 match and meet the matching principle, it would be my
18 opinion that the deferral should be amortized because
19 that's the only way the company can get a return of its
20 investment that it made in order to generate those
21 savings. Those are two standards that I think that
22 apply here.

23 Q. Okay. Should the Commission be reasonably certain of
24 approving the ultimate recovery of the costs before it
25 approves deferred accounting treatment?

1 A. I'm sorry. Can you repeat that for me, Mr. Spenard?
2 Q. Yes, sir.
3 A. I want to be certain I heard what you said.
4 Q. Oh, sure. Is it your opinion that the Commission
5 should be reasonably certain of approving the ultimate
6 recovery of the costs before it approves the deferred
7 accounting treatment of the costs?
8 A. I don't think that's the standard on which the
9 Commission has to operate. I think that, by approving
10 an accounting deferral, they are not explicitly
11 approving future rate recovery. I think, given my
12 position that I described in my testimony in the
13 company, I think rate recovery is proper in this case
14 obviously, but I will say that I don't think accounting
15 approval of a deferral is explicit approval of future
16 ratemaking.
17 Q. Okay. With regard to security costs, am I correct that
18 the company filed a petition in November 2001 seeking
19 to establish a surcharge for recovery of those costs?
20 A. Yes, you're correct.
21 Q. Okay, and that surcharge request was later withdrawn by
22 the company; is that correct?
23 A. It was withdrawn, yes, as a condition to approval to, I
24 think it is, Case 2003-00018 (sic) (Court Reporter's
25 Note: Case 2002-00018) or/and 00317, 2002-00317.

- 1 Q. Okay, and the company subsequently sent a letter to the
2 Commission requesting deferred accounting treatment for
3 these costs; is that correct?
- 4 A. Yes, sir. I've explained in my testimony that we felt
5 that the language of that Condition No. 2 from the
6 Order in 2003-00317 (sic) (Court Reporter's Note: 2002-
7 00317) clearly indicated to us that we couldn't recover
8 it in revenues at that time, but we were free to
9 recover it in a future general rate filing. I think,
10 in response to one of the data requests, and I can find
11 it, but I don't have the number here in front of me, we
12 indicated, I think, the first correspondence was from
13 Herb Miller to the Commission in 2003, maybe sometime
14 in July. We didn't really hear anything from that. We
15 again filed a letter in September of 2003 requesting,
16 and those letters and the future correspondence from
17 that initial letter in September of '03 are attached to
18 my testimony as Exhibits, I think, 7 and 8.
- 19 Q. Okay, but the letter from Herb Miller, was that
20 attached as an exhibit to your testimony?
- 21 A. It was not. I was not aware of that letter until the
22 data request that we have and, through research in
23 answering that data request, it did come to my
24 knowledge that that letter had been filed.
- 25 Q. Okay. With regard to a letter from the Public Service

1 Commission to counsel for Kentucky-American, dated
2 October 15, 2003, this letter was the Commission's
3 response to Kentucky-American's request to establish
4 regulatory assets for security costs?
5 A. Yes, sir, it was.
6 Q. Okay, and, in sum, the letter says no?
7 A. That's correct, and we didn't agree with the reasoning
8 behind that letter and, on November 21st - I'm sorry -
9 on November 18, 2003, we followed that up with a letter
10 back to the Commission asking for reconsideration on
11 that issue.
12 Q. Well, with regard to the reason, - this is in the
13 October 15th letter - the reason for the "No" is cited
14 in the third paragraph of that letter, indicating that
15 - it's pointing out language from conditions that
16 Kentucky-American, among others, accepted in the
17 acquisition case, RWE acquisition case, 2002-00018.
18 That's the basis for their "No."
19 A. It was an interpretation of Condition 2 of the Order
20 that we talked about and just what that condition was.
21 It's pretty short: "At no time prior to May 30, 2007
22 will KAWC apply to the Commission for recovery of costs
23 associated with the protection of water utility assets
24 except through adjustments in its general rates for
25 water service." And we felt that, based on our

1 interpretation of that language, that that did not
2 preclude us from seeking deferral. It only required us
3 that we couldn't change rates before then unless it was
4 done in a general rate case, and that was the subject
5 of our request for reconsideration in the letter of
6 November 18th. We asked the Commission to reconsider
7 that and, based on our interpretation of that Order,
8 that we were only asking for an accounting deferral and
9 any rate recovery in the future would be handled in a
10 general rate case, and, again, that's where we're at
11 and that's what we're asking the Commission to do in
12 this case, is to consider the rate recovery of that
13 security.

14 Q. And the Staff response to that request, to the
15 company's request for reconsideration, was by letter
16 dated November 21, 2003, and, in that letter, Staff
17 indicates that it is giving additional consideration to
18 Kentucky-American's request?

19 A. It did, and I think that's probably the last official
20 document or correspondence we've had on that subject.
21 We did supply the information regarding what other
22 states had done in regards to this, as requested in the
23 October letter from Staff, and that was supplied along
24 with the letter on November 21st.

25 Q. And these other states, Missouri, Pennsylvania, and

1 West Virginia, each of those states is a jurisdiction
2 that has a Kentucky-American sister corporation; is
3 that correct?
4 A. They are; yes, sir.
5 Q. Okay, and, as of today, the Commission has not
6 authorized deferred accounting treatment for security
7 costs?
8 A. They have neither, in my opinion, approved or denied
9 accounting treatment for the deferral of security costs
10 and again brings us right back to where we are; that
11 we're in a general rate filing now and we're asking the
12 Commission to consider the request of the company to
13 defer the security costs that occurred during this
14 period for future rate recovery.
15 Q. Okay. I'm going to ask you a question about one of
16 your responses to a data request, and this is the
17 Response to PSC 2-115.
18 A. Can I get that, sir?
19 CHAIRMAN GOSS:
20 Sure. Do whatever you need to do to get it.
21 A. PSC 2-15?
22 MR. HOWARD:
23 2-115.
24 A. Did you say 115 or 15?
25

1 MR. HOWARD:
2 115.
3 Q. 115.
4 A. I think I have it, sir.
5 Q. Okay. If you'll bear with us for just a few seconds.
6 Okay. You sponsored this response in regard to what's
7 known as the slippage factor; is that correct?
8 A. Yes, sir, I did.
9 Q. And if Kentucky-American does not meet its projected
10 plant in service additions for the forecasted period,
11 there are several components of the company's rate base
12 that would be affected; is that correct?
13 A. If we did not spend the money that we included in our
14 forecasted test year? Is that the question?
15 Q. If you didn't meet your projected plant in service
16 additions for the forecasted period.
17 A. If we did not spend the money and closed the utility
18 plant, the capital spending that we included in our
19 filing, that's certainly true. That's why historically
20 the Commission has looked at the slippage factors to
21 say and go back and look at what we did actually versus
22 what we plan to do.
23 Q. So utility plant in service would be impacted by
24 slippage; is that correct?
25 A. Yes, sir.

1 Q. As well as reserve for depreciation?
2 A. If we didn't spend the money, that's true.
3 Q. And with regard to construction work in progress, would
4 that be impacted by the slippage factor?
5 A. Well, certainly, if we did not spend the money, the
6 CWIP would not be there.
7 Q. Contributions in aid of construction?
8 A. All those items that you've mentioned, we supplied
9 information based on historical slippage; yes, sir.
10 Q. Okay. With regard to the company's Annual Incentive
11 Plan, AIP, . . .
12 A. Can I put away this . . .
13 Q. Yes.
14 A. There will probably be more brought out. Thank you.
15 Q. Sure. And we'll go Page 48 of your direct testimony.
16 A. I'm there, Mr. Spenard.
17 Q. Okay. The plan consists of three components; is this
18 correct?
19 A. You mean the measures that we're using to determine
20 payments under the plan?
21 Q. Yes.
22 A. That's correct.
23 Q. Okay, and these are outlined on Page 49?
24 A. Financial, operational, and individual goals; yes, sir.
25 Q. Okay, and 60 percent of the AIP is weighted by the

1 financial component of the plan; is that correct?
2 A. For all the employees impacted at Kentucky-American,
3 that's true; yes, sir.
4 Q. Okay, and the financial component of the plan includes
5 two measures, value added and free cash flow?
6 A. That's correct.
7 Q. Okay, and you indicate that, "Value added is the
8 product of the pre-tax operating result return on total
9 invested capital in relation to the cost of capital";
10 is that correct?
11 A. Yes, sir.
12 Q. Can you provide an example of how the calculation would
13 work?
14 A. Sure. I mean, a hypothetical example?
15 Q. Yes, sir.
16 A. Let's just say a company had a million dollars of
17 capital invested. That would be your capitalization.
18 Theoretically, your rate base matches that or something
19 close to it. Let's just say they had a million
20 dollars. Let's say a company had a return, a pre-tax,
21 pre-capital cost return of \$100,000. They would have a
22 return on invested capital of 10 percent. Let's just
23 say that they had an expectation or the market or the
24 investor hurdle rate, if you will, similar to the
25 weighted cost of capital in this case that we're

1 talking about, only it would be pre-tax, if that was
2 10 percent and we earned a return on invested assets of
3 10 percent, we did not lose value and we did not gain
4 value; we just met expectations. If the pre-tax return
5 were \$90,000, we would have a return of 9 percent, but
6 the expectations would be 10 percent. So we have, in
7 essence, destroyed value. If we had a return of
8 \$110,000, we'd have 11 percent return. If the
9 expectation was 10 percent or the hurdle rate, then we
10 would have created value for the difference between the
11 \$110,000 and the \$100,000. Is that . . .

12 Q. Yes, sir.

13 A. . . . a good answer or an appropriate answer?

14 Q. That's fine. With regard to the second financial
15 component, that is free cash flow which equals cash
16 from operations less capital investment and it is
17 linked to the level of net debt of the company; is that
18 correct?

19 A. Yes, sir. Free cash flow is how much cash you
20 generate, either positive or negative, and, to the
21 extent that you don't generate enough cash to cover
22 your cap ex and other internal cash requirements, it
23 can affect your borrowing, . . .

24 Q. Well, how . . .

25 A. . . . would increase borrowing effect.

1 Q. I'm sorry. I interrupted. Is that it? I'm sorry to
2 interrupt you.

3 A. Uh-huh.

4 Q. How do you determine cash flow?

5 A. Well, I mean, the statement of cash flows, it begins
6 with net income. It adds back non-cash items that
7 might have been reflected on your income statement. It
8 deducts cash payments that may be reflected on an
9 accrual basis on your income statement to come
10 basically to how much cash from operations are you
11 generating in real dollars, cash, and then you simply
12 subtract your cash expenditures for your capital
13 spending or other things like dividends or sinking
14 funds, those things that you might have to spend cash
15 for also, to determine, at the end of the day, did you
16 have some cash left over, did you generate some cash
17 for the year, and, if you didn't generate enough cash
18 to cover those items, then you would theoretically have
19 to borrow that money and increase your capitalization.

20 Q. Okay. Well, does the depreciation expense increase or
21 decrease the company's cash from operations?

22 A. I mean, it's - the company recovers in rates an
23 allowance for depreciation, so it generates cash, if
24 you will, in the form of revenues, but that is really a
25 return of the investment the company made in utility

- 1 plant, and so forth, over the entire time it's been in
2 business. So it's not like it's just cash, I mean,
3 free. It is a return component of the company's
4 investment.
- 5 Q. On a cash flow statement, it's a source of cash; is
6 that correct?
- 7 A. Well, certainly, because you start with a book net
8 income, Mr. Spenard, which is reduced for depreciation.
9 So, to get to your cash from operations, you need to
10 add back depreciation.
- 11 Q. Okay. The company has also included costs for a Long-
12 Term Incentive Plan; is that correct?
- 13 A. Yes, sir.
- 14 Q. And, at the time of the filing, Mr. Mundy was the only
15 Kentucky-American Water Company employee eligible for
16 the LIP; is that correct?
- 17 A. That's correct. It's the position the President of the
18 company is eligible for the LIP. Mr. Mundy was that
19 person at the time we filed the case.
- 20 Q. Okay. The company has included CWIP in this case,
21 construction work in progress; is that correct?
- 22 A. We have included it as a rate base item, just as we
23 have in every case since we began filing forecasted
24 test years, I think, in 1993.
- 25 Q. Okay. Do you know the latest completion date of any

1 project included in construction work in progress?
2 A. Well, Mr. Spenard, I do not have in front of me the
3 completion dates for each one. I think, through the
4 documents we have or we can certainly supply to you,
5 there are a number of capital projects that were
6 included in CWIP balances during the forecasted test
7 year that will be completed as we go along, and we
8 forecasted that way.
9 Q. Well, rather than getting the number of completion for
10 each one, I'm curious if you know what would be the
11 latest completion date for any of the projects; not all
12 of them, just the one that has the latest completion
13 date.
14 A. Let me - the latest date would be November 2005,
15 because there would certainly be some of the projects
16 that we began or plan to do during the forecasted
17 period that still would not be complete as of November
18 2005; otherwise they would be utility plant versus
19 CWIP.
20 Q. Okay. You have some exhibits to your direct testimony,
21 and one of the exhibits is Exhibit MAM-1.
22 A. I have that, sir.
23 Q. Okay. How do you develop the net income available for
24 common stock amounts that appear on the first line?
25 A. For the years 2000 through 2003, I took that

1 information off of our audited financial statements.
2 For 2004, we have a budget - we call it a reforecasting
3 method that we do throughout the year where we take
4 actual year-to-date plus the budget for the remaining
5 part of the year, adjusted for any known and measurable
6 changes to those budgets over the remaining part of the
7 year, to arrive at a projection for the year. The 2004
8 number came from our internal reforecasting process.
9 2005 is, again, it's projected of what our planning
10 process is right now, our reforecasting process for
11 2005, and it assumes no rate relief in this case.

12 Q. Okay. With regard to the results, the actual results,
13 for the years 2000 through 2003, did you make any
14 adjustment to actual revenues or expenses to reflect
15 such factors as weather normalization, elimination of
16 costs that are not recoverable from ratepayers, or any
17 other adjustments?

18 A. I made no adjustments, sir. Those are per books
19 numbers.

20 Q. Okay, and, with regard to the amount of common equity,
21 was that taken directly from the company's balance
22 sheet?

23 A. It was.

24 Q. Okay. With regard to your rebuttal testimony,
25 Page 15, . . .

1 A. I'm sorry, sir. I didn't hear that.

2 Q. Oh. We're going to take a look at your rebuttal
3 testimony, Page 15.

4 A. Yes, sir.

5 Q. All right. You discuss \$9.2 million in rate base that
6 Ms. Crane recommends be disallowed; is that correct?

7 A. I think I indicate that we're rebutting \$9.2 million of
8 rate base that Ms. Crane did not recommend approval
9 for.

10 Q. Okay. In Line 27, you indicate that the revenue
11 requirement impact of this disallowance is worth
12 approximately \$1.1 million.

13 A. Yes, sir. That's what I testified to.

14 Q. Okay. With regard to this, approximately two-thirds of
15 this disallowance is the construction work in progress
16 disallowance of Ms. Crane in the amount of roughly
17 \$6.1 million; is that correct?

18 A. Yes, sir. On Rebuttal Exhibit MAM-5, I tried to recap
19 those items and how I arrived at my number, or at least
20 the difference in rate base. Of the total \$9.501 mil-
21 lion that we're rebutting, \$6,124,953 applied to CWIP.

22 Q. What would the revenue requirement impact of only the
23 construction work in progress disallowance be?

24 A. I think I testified to that somewhere in here, Mr.
25 Spenard. I think I indicated it was approximately

1 \$130,000 that - as treating that as rate base with an
2 offsetting above-the-line revenue adjustment for AFUDC
3 versus eliminated entirely was approximately \$130,000
4 that it lowered our revenue requirement in this case.
5 I can find that exact number, but it's in that range.
6 Q. Does that . . .
7 A. It's on Page - if you're interested, Mr. Spenard, it's
8 on Page 19, Question 42, or answer to Question 42 on
9 Line 21 of Page 19, \$132,890.
10 Q. Okay. Does that \$1.1 million disallowance include the
11 adjustment for AFUDC?
12 A. Absolutely.
13 Q. So that \$1.1 million is net of the AFUDC adjustment?
14 A. What I did, sir, was take a return grossed up for taxes
15 on the \$9.5 million, as you would a normal revenue
16 requirement on rate base, and I reduced that revenue
17 requirement by the amount of AFUDC, so that the
18 \$1.1 million is net of the lowering, if you will, of
19 the revenue requirement for the AFUDC associated with
20 CWIP.
21 Q. Page 17 of your rebuttal testimony, . . .
22 A. Yes, sir, I have it.
23 Q. All right. Tri-Village, you indicated that Tri-Village
24 did not recover depreciation expense prior to its
25 acquisition; is that correct?

1 A. That is my understanding, sir. Yes, it is.

2 Q. Okay. Did Tri-Village have a cost of equity?

3 A. Sure. Every company has a cost of capital, but the
4 fact of the matter is Tri-Village was a public system
5 and they had no equity. They were entirely financed
6 with debt and grants, if I'm not mistaken.

7 Q. Okay. Did they pay state and federal income taxes?

8 A. I don't know the answer to that. I doubt it, but I'm
9 not certain about that.

10 Q. Okay. Do you know whether or not they paid property
11 taxes?

12 A. I don't know the answer to that. I haven't reviewed
13 that model in some time, sir.

14 Q. Okay, and Kentucky-American is requesting inclusion of
15 a return on equity on the Tri-Village assets; is that
16 correct?

17 A. Certainly. It's one of the things in this case, is
18 that Kentucky-American has one, only one, capital
19 structure for its overall corporation, but, in regards
20 to setting the proper tariffs for both our Central
21 Division and our Northern Division, which is Elk Lake
22 and Tri-Village, which we're proposing separate rates
23 even for those two districts, we still have to allocate
24 back a portion of our overall capital to those two
25 entities or all three divisions in order to set rates

1 in this case. That's my understanding of what would be
2 the proper ratemaking methodology. That's what we did.
3 Q. So, likewise, Kentucky-American is requesting recovery
4 of state and federal income taxes on the revenue from
5 these customers; is that correct?
6 A. To the extent that - yes, absolutely.
7 Q. And the company will pay property taxes on the Tri-
8 Village property?
9 A. To the extent - yeah, yeah. Whatever the value of that
10 is for property tax purposes, that's true.
11 Q. Okay. Turning to Page 22 of your rebuttal testimony,
12 and we're back to deferring costs, you discuss the fact
13 that rate recovery of a cost must be likely in order
14 for a cost to be deferred; is that correct?
15 A. Yes, sir. That's what I testified to.
16 Q. Okay. What documentation did your auditors require
17 from Kentucky-American to demonstrate that the
18 reorganization costs for the Service Company and the
19 Customer Care functions and the security costs were
20 likely to be approved for recovery by the Commission?
21 A. Mr. Spenard, I supplied that in a data request in the
22 last go-around. Can I get those documents out?
23 Q. Yes, sir.
24 A. I need to find them. I'm not exactly sure which data
25 request it was.

1 MR. INGRAM:
2 I think it's PSC 4. You're looking at PSC 4.
3 A. I've got it here.
4 OFF THE RECORD
5 A. I'm not having any luck finding it yet, sir. Hold on
6 just a second, if you don't mind.
7 OFF THE RECORD
8 MR. INGRAM:
9 LFUCG?
10 MR. HOWARD:
11 4-3, I think.
12 MS. CRANE:
13 I think it's 3-4.
14 MR. HOWARD:
15 3-4.
16 A. Mr. Spenard, that information was supplied in response
17 to LFUCG Third Data Request, No. 4. Documents are
18 attached to that data request.
19 Q. Do those documents include the Commission's October
20 15th letter?
21 A. October 15, 2003?
22 Q. Yes.
23 A. No, it does not.
24 Q. Okay. Were your auditors aware of the October 15, 2003
25 letter?

1 A. I think we did cover it in our review with them when
2 the Price Waterhouse auditors were in our office last
3 fall. I also went over with them, although I didn't
4 give them copies of the letter, I went over the
5 response from the Commission, I think, on November
6 18th, that they were still reviewing this, but still
7 yet, and based on my opinion, which is what was
8 required, that I think the future rate recovery is
9 likely for all the reasons that we've described in our
10 testimony in this case.

11 Q. Did you put that opinion in writing?

12 A. I did. Since back in '02 to them, I've put it in
13 writing. They do have the schedules that were attached
14 to the Response to LFUCG 3, No. 4, and I supplied that
15 again, as you see back there, I believe, at the end of
16 '02. I discussed it with the auditors. When they're
17 in, they always ask those kind of questions about every
18 deferred regulatory asset we have.

19 Q. Okay.

20 A. That's one of their key components of their audit that
21 they look at.

22 Q. Okay. Page 31 of your rebuttal, you discuss Ms.
23 Crane's salary and wage adjustment. Is it your under-
24 standing that Ms. Crane is recommending disallowance of
25 the three specific positions of crew leader, meter

1 reader, and engineer?

2 A. I'm not sure what Ms. Crane is recommending. She
3 appeared to be recommending some kind of just three
4 people's average cost, which would include top manage-
5 ment of the company at a significantly higher pay
6 level. Those are generally not where the vacancies
7 occur. But, in response to a data request, we did
8 provide - these were the three vacancies at the time we
9 were asked about that data request. Since she was
10 recommending three, I wanted to point out the three
11 vacancies that we did indicate were there and what the
12 true cost of those three vacancies was versus the
13 recommendation of Ms. Crane. That was the point of me
14 making this part of my testimony, because I wanted to
15 be clear that these were the three vacancies that we
16 had responded to in a data request.

17 Q. Well, since the filing of the rate case, there was a
18 departure of one of the top salaried employees in that
19 Mr. Mundy left; is that correct?

20 A. Yes, but Mr. Rowe has been appointed President of the
21 company now and he's there to replace Mr. Mundy.

22 Q. Okay. Does Mr. Rowe have other responsibilities other
23 than simply overseeing Kentucky-American?

24 A. Mr. Rowe, after he left the company originally as a
25 Kentucky-American employee as VP of Operations, he did

1 accept a position with American Water Works in our
2 corporate office dealing with some projects that are
3 going on systemwide there. On Mr. Mundy's departure,
4 Mr. Rowe was appointed President. Obviously there is
5 some transition time for Mr. Rowe to handle some of
6 those activities that he was being - very important
7 activities that he was responsible for. That's why he
8 was left on the Service Company, so it would make it
9 very easy for him to allocate his time to wherever he
10 might be working versus putting him on Kentucky's
11 payroll, having to issue interoffice memos and invoices
12 and all those things to take care of that, but the
13 answer is, the short answer is, that there has been a
14 transition period. From where Mr. Rowe was working, he
15 has continued to help with that process until he can be
16 freed up to take over the full-time responsibilities at
17 Kentucky. He's working - he's a very busy, hardworking
18 man doing those dual roles right now.

19 Q. Okay. With regard to Page 32 of your rebuttal
20 testimony, Lines 21 through 25, you state that the
21 company has not included one penny of any external cost
22 associated with the condemnation effort; is that
23 correct?

24 A. To the best of my knowledge, Mr. Spenard. I mean,
25 we've scrubbed this case from since we filed it. We

1 eliminated every dollar that we knew about. To the
2 best of our ability, we have tried to transfer all that
3 into a segregated account so that we knew exactly what
4 it was and we eliminated those from a forecasted
5 filing; yes, sir.

6 Q. Okay. Did the company track internal costs associated
7 with the condemnation?

8 A. Define "internal costs," please.

9 Q. The cost of the Kentucky-American employees.

10 A. We've covered this in literally dozens of data requests
11 up to this point. The answer is we did not. The
12 summary of those many, many data requests that we filed
13 were this: Kentucky-American essentially and basically
14 has the same number of management employees it did
15 before the condemnation effort and the same number of
16 management employees it will need to operate its
17 company once the condemnation is complete. Any
18 additional duties regarding the condemnation had to be
19 absorbed through non-paid overtime of our management
20 employees to absorb those costs. So therefore we don't
21 feel there is any additional cost that Kentucky-
22 American has had in regards to its internal labor
23 regarding the condemnation that's being requested for
24 recovery in this case.

25 Q. And therefore it was not tracked?

1 A. We've repeatedly said in data requests it was not
2 tracked. I don't know how many unpaid overtime hours
3 those folks worked. I know they were considerable,
4 but, for those reasons, we did not track it.

5 Q. With regard to the Customer Care Center in Alton,
6 Illinois, can you briefly identify the services being
7 provided in Alton?

8 A. Can I briefly describe those services?

9 Q. Sure. Exactly . . .

10 A. Sure. I mean, we do customer contact. If a customer
11 wants to call for initiation of service, turn off
12 service, a billing dispute, whatever it may be, the
13 call goes to that 1-800 number. That is a broad range
14 of duties that is covered with that. I'll be brief,
15 but I'll just call it customer contact. They handle
16 that essentially, at least by the phone contact. We do
17 billing services there. They do - the meter reading
18 edits are sent there. They're reviewed. The bill
19 editing process is complete there and before those
20 meter readings are submitted to final billing. We have
21 a collections area whereby they are in charge of
22 pursuing the collection of our accounts in a timely
23 manner. I mean, there's data processing; there's HR.
24 There's all kinds of other departments that are
25 auxiliary to providing the support service to those

1 functions, but those are the three primary functions of
2 the Call Center.

3 Q. Are any of those Customer Care functions being
4 performed locally at Kentucky-American or regionally
5 somewhere in the Southeast Region as opposed to being
6 performed in Alton?

7 A. Absolutely. We still have the ability for our
8 customers to walk in the office at 2300 Richmond Road
9 in our Northern Division Office, if they choose to do
10 so. We collect payments there. If there is a customer
11 that absolutely needs service in person, we take care
12 of that at our two offices.

13 Q. Roughly, about how many employees are involved in
14 taking care of that at those two offices?

15 A. I'd have to go back and check, Mr. Spenard. I think
16 it's probably in the neighborhood of six to eight, in
17 that range.

18 Q. Okay. Are there any plans to terminate the use of
19 these six state employees?

20 A. There is some discussion about the order closing
21 process. What we do right now is, once the orders come
22 from Alton, they work them in the field. The staff
23 there at Kentucky-American at least has to close those
24 orders on the system so that the computer system knows
25 that order is complete. There is some talk of possibly

1 centralizing that function because for the same reasons
2 that we continue to try to improve, that we think we
3 can do it better, cheaper, and less costly.

4 Q. So with respect to the people in the field, they would
5 be able to bypass the employees at Kentucky-American
6 and deal directly with Alton, Illinois?

7 A. No, no. That's kind of a back office function that I'm
8 talking about, order closing. We have no intentions of
9 eliminating the remaining of those employees or
10 reorganizing the remaining number of those employees
11 that deal with customer contact and collecting at our
12 offices right now. It's more of the back office
13 function.

14 Q. How many of the employees - how many employees are
15 involved in back office functions?

16 A. I mean, subject to check, Mr. Spenard, I think it's
17 three.

18 Q. Okay. So, currently, when someone calls Alton,
19 Illinois, there are at least some functions where
20 Alton, Illinois is coordinating with non-field
21 employees in the Kentucky-American service territory;
22 is that correct?

23 A. Yes, sir. They do both. They may contact field people
24 directly in some instances or supervisors directly in
25 other instances. There may be some dispatching of

1 those work requirements through Kentucky-American's
2 back office.

3 Q. Okay, and with regard to the people in the field, in
4 terms of technology, are we seeing a movement in
5 technology where that the people in the field are going
6 to be able to bypass the jobs that may currently or may
7 have in the past been done by the representatives in
8 the Kentucky non-field category in coordinating with
9 Alton? Are we going to see a bypass of that function,
10 or have we seen a bypass of that function?

11 A. I'm not sure I fully understand. Let me try to answer
12 the question the best I can and, if it's not what
13 you're after, I'll try again. Are we looking at things
14 like mobile computing and things like that that could
15 lower our back office staff? Yes, sir, we are, in
16 fact, looking at those kinds of things where, instead
17 of the, you know, person in the field writing down the
18 results of an order on a piece of paper and handing
19 that piece of paper to someone else, to have a mobile
20 computing device in their truck where we could route
21 them and things like that, yes, we are looking at those
22 kinds of things as we speak.

23 Q. Well, is Kentucky-American currently utilizing mobile
24 computing in its service territory?

25 A. I think it's just in its inception phase right now.

1 Q. And is there a schedule to expand it?

2 A. I don't think there's a schedule to expand it. I mean,
3 there are things being talked about, like GIS and
4 things. I think those are longer range than what we're
5 doing right now. I'm not exactly sure when the time
6 frame for some of those further enhancements that will
7 be out there. There's a lot of work that has to be
8 done to make those things happen.

9 Q. Well, with . . .

10 A. Probably in a couple of years horizon.

11 Q. Okay. With regard to those further enhancements, will
12 that present a situation where the local workforce can
13 be reduced as a result of mobile computing?

14 A. Likely, sir, yes. Yes, I think, if those back office
15 functions, if you're not passing the paper around,
16 that's one of the reasons to do it. You wouldn't make
17 those kind of investments in the equipment and the
18 technology unless there was some efficiency gains to be
19 had and savings.

20 Q. With regard . . .

21 A. But none of the costs - none of the capital costs are
22 in this case for that either.

23 Q. Okay. With regard to procurement practices, American
24 Water Works has some power to approach vendors and buy
25 in bulk; is that correct?

- 1 A. Yes, sir. We've been trying to be more effective in
2 our procurement initiatives. I think in the "Best
3 Practices" report that we made earlier this year, we
4 identified some synergies that have been generated that
5 are embedded in both our base period and our forecasted
6 period from that effort.
- 7 Q. Okay. Does Kentucky-American or the Service Company
8 use any purchasing cards or credit cards to buy items
9 or pay bills?
- 10 A. Yes, sir. We use - we have what we call P-cards that
11 are issued to certain employees. I don't think every
12 employee has a P-card, but the majority probably do
13 these days.
- 14 Q. Well, are there any rebates associated with the use of
15 these P-cards or purchasing cards?
- 16 A. Yes, and those rebates are flowed back to each state
17 based on the level of purchases that they did to
18 generate those. Those savings are embedded into the
19 base period in this case and are carried forward into
20 the forecasted period.
- 21 Q. Okay, and are you able to quantify the magnitude of the
22 rebates received with regard to the forecasted test
23 period?
- 24 A. Mr. Spenard, it would be carried forward, whatever is
25 in the base period. I don't have that number in front

1 of me right now, but we can certainly supply that.

2 Q. Okay. If we have that as a data request, we'll ask for
3 it, but, for now, no. Let's move on to, hopefully, the
4 last few items. This is in regard to a response that
5 you made to our Second Request for Information. This
6 is Item 17.

7 A. AG 2-17?

8 Q. Yes, sir.

9 A. Can I grab that, please?

10 Q. Sure.

11 A. It takes a long time to get by AG No. 1, Mr. Spenard.

12 Q. There are lots of material in this case.

13 A. I think I have it, sir.

14 Q. Okay. There's a line that has a base period amount for
15 business development costs and a forecasted period
16 amount for business development costs. Do you see
17 those?

18 A. The numbers \$111,865 for the base period and \$117,525
19 for the forecast period?

20 Q. Yes, sir.

21 A. Yes, sir.

22 Q. And these are amounts included in the Southeast
23 Region's management fees for this particular expense
24 category.

25 A. That's correct.

1 Q. And does business development include business
2 development for wastewater activity?
3 A. It could.
4 Q. Does it include business development for a non-
5 regulated matter such as O&M?
6 A. Business development certainly includes potential
7 customers in the non-reg area, yes.
8 Q. Okay.
9 A. That's one reason that we have placed our business
10 development people on the Service Company, so that they
11 could easily charge their time to non-reg operations or
12 wastewater operations when it's appropriate to do so.
13 For instance, if they were on Kentucky's payroll but we
14 wanted to bill American Water Works Service, it would
15 require us tracking that time, generating a
16 miscellaneous invoice internally, sending that to a
17 sister company, generating a transaction to pay or send
18 money back and forth in our company. So, just from an
19 accounting standpoint, it's much more efficient to have
20 these folks on the Service Company where they can
21 allocate their time to both reg, non-reg, wastewater,
22 whatever the situation may be.
23 Q. Well, do you have any reason to anticipate that
24 Kentucky-American will attempt to cross-sell between
25 regulated and non-regulated businesses and product

1 lines?

2 A. Will Kentucky-American?

3 Q. Yes, sir.

4 A. No, sir.

5 Q. Okay. With regard to Kentucky-American, will it

6 coordinate its non-regulated business with the

7 regulated business to maximize market share advantage

8 in Kentucky?

9 A. Will we use Kentucky-American's footprint to pursue

10 non-reg options? The answer to that is obviously yes.

11 Q. Okay, and, in terms of coordination, will the company

12 coordinate with its non-regulated business?

13 A. Certainly we'll coordinate and, when that takes place,

14 the proper charges will be made to the non-regulated

15 entity.

16 Q. Okay. Are Service Company employees required to

17 affirmatively allocate out all of their hours, or is

18 there some type of a residual or default allocation for

19 the Service Company employees?

20 A. Each Service Company employee is required to fill out a

21 time sheet for each week, Mr. Spenard. Historically,

22 we allocate eight hours. If I work twelve hours in a

23 day, I'm only permitted to allocate eight hours. I

24 have the option, if I was working on something directly

25 for Kentucky-American, I would charge Account No. 380.

1 That's the company number for Kentucky-American. If I
2 was working on an overall business plan for all five
3 states in my region, I may charge a formula, and each
4 and every Service Company employee is required to make
5 those determinations when they fill out their time
6 sheet to appropriately allocate their costs where they
7 should go.

8 Q. Okay, and, hopefully, this will be it. We've been at
9 this quite awhile. I appreciate your patience.

10 MR. HOWARD:

11 Is that for Phase I?

12 Q. This is OAG - excuse me. This is Mr. Miller's Response
13 to the Public Service Commission's Fourth Information
14 Request, Item 28.

15 A. Can I get that, Mr. Spenard?

16 Q. Yes.

17 A. Thank you.

18 Q. Unless you have it memorized.

19 A. Mr. Spenard, there is no way I could memorize all of
20 these data requests with my name on them.

21 Q. I think that Linda Bridwell could. I think that Linda
22 Bridwell does. Okay. Just tell me when you're ready.

23 A. Are we talking about security, sir?

24 Q. Yes, sir.

25 A. Okay.

1 Q. Okay. There's a schedule that appears and it shows the
2 jurisdictions, oddly enough, with the number of
3 customers and it gives basically the status of where
4 they stand with regard to the treatment of deferred
5 security costs; is that correct?
6 A. Yes, sir, and I did have this schedule already pulled
7 out and laid here. So it did cross my mind you may ask
8 me about that.
9 Q. Okay, and there are, as I count, eight footnotes that
10 indicate the status, eight different notations for the
11 status.
12 A. That's correct.
13 Q. And some of the jurisdictions have more than one
14 footnote with regard to their status.
15 A. Yeah. That's because some states may have more than
16 one tariff that they file at different times, like
17 California, I think, and then some of them, even though
18 there's an Order or a decision indicated, it also
19 indicates that those may be under appeal at some higher
20 jurisdiction. If I could, I received some information
21 regarding this schedule just yesterday, that, in
22 Pennsylvania, which indicates a "3" which means it's
23 under appeal, the appellate court in Pennsylvania
24 upheld the Commission's ruling permitting cost
25 recovery, rate recovery of security costs. So you can

1 take the "3" off of Pennsylvania as of yesterday.

2 Q. Okay. With regard to the overall schedule, though, the
3 treatment in other jurisdictions has not been uniform?

4 A. I wouldn't say that. I think, with the exception of
5 the ones that have a "2" beside their name, I think
6 they received some cost recovery. I think some of the
7 classifications simply indicate it was handled in a
8 stipulated case versus a litigated case. So I wouldn't
9 say they've been handled differently. They just got to
10 the same answer in a different way.

11 Q. Can you explain Footnote 7, "Deferred costs have
12 already been amortized"? Does that mean that they've
13 already been included in rates?

14 A. I think that's what that means; yes, sir.

15 Q. Were they recovered by the company between rate cases?

16 A. I think what that means, Mr. Spenard, is that they may
17 have been handled in between rate cases. For whatever
18 reason, they didn't have to - they went ahead and
19 amortized that off in between rate cases, is what it
20 means. Not necessarily that it was recovered in rates,
21 but the company, for whatever reason, wrote it off
22 between rate cases.

23 Q. Thank you, Mr. Miller.

24 MR. SPENARD:

25 And I think this marathon is at its end.

1 CHAIRMAN GOSS:
2 Thank you, Mr. Spenard. It wasn't a marathon.
3 You did a good job. I know I said we would go
4 until five. We're at a good stopping place, and
5 so I'm going to propose, unless someone has a
6 serious objection, that we stop for the day and
7 come back at nine o'clock in the morning. Let me
8 ask this question. It looks like - let's see. Do
9 you three gentlemen, Mr. Childers, Mr. Barberie,
10 and Mr. Ockerman, are you all going to have
11 questions for Mr. Miller?
12 MR. BARBERIE:
13 I have a number of questions and it will just
14 depend on how Mr. Miller answers them.
15 CHAIRMAN GOSS:
16 Okay. It usually does.
17 MR. OCKERMAN:
18 I will have some questions, Mr. Chairman.
19 CHAIRMAN GOSS:
20 Okay. Mr. Childers?
21 MR. CHILDERS:
22 I will also.
23 CHAIRMAN GOSS:
24 Okay, and I know Mr. Wuetcher does, so it might
25 take - who knows how long it will take to finish

1 with Mr. Miller tomorrow. Mr. Ingram, it looks
2 like that you've still got Ms. Valentine and Mr.
3 Jarrett. Do you still intend to call those two
4 witnesses?

5 MR. INGRAM:

6 I do, Your Honor, . . .

7 CHAIRMAN GOSS:

8 Okay.

9 MR. INGRAM:

10 . . . as long as there are questions for them.

11 If there are no questions, I won't call them.

12 CHAIRMAN GOSS:

13 Well, that's a good point. Are there questions
14 for Mr. Jarrett and for Ms. Valentine that are
15 anticipated?

16 MR. BARBERIE:

17 I have questions for both, Your Honor.

18 CHAIRMAN GOSS:

19 Okay. All right. Well, they'll need to come,
20 then. That's all I need to hear. Do you all
21 anticipate that their cross examination of Mr.
22 Jarrett and Ms. Valentine will be lengthy?

23 MR. SPENARD:

24 Our cross examination for Mr. Jarrett will not
25 be lengthy and, for Ms. Valentine, we have a fair

1 number of questions for her.

2 CHAIRMAN GOSS:

3 Okay. How about you gentlemen?

4 MR. BARBERIE:

5 Ms. Valentine, no on the length and, Mr. Jarrett,

6 probably not.

7 MR. OCKERMAN:

8 No questions for Ms. Valentine and very few for

9 Mr. Jarrett.

10 CHAIRMAN GOSS:

11 Okay. All right.

12 MR. WUETCHER:

13 Your Honor, we don't anticipate any questions for

14 Ms. Valentine.

15 CHAIRMAN GOSS:

16 Okay.

17 MR. WUETCHER:

18 As to Mr. Jarrett, we will have a few.

19 CHAIRMAN GOSS:

20 All right. Now, I presume - of course, then the

21 AG will call Ms. Crane and Mr. Rubin, Scott Rubin.

22 I presume Ms. Crane's cross examination will take

23 some goodly period of time.

24 MR. INGRAM:

25 Probably not too long, Your Honor.

1 CHAIRMAN GOSS:
2 Okay. All right.
3 MR. BARBERIE:
4 Are there any further developments on Mr. . . .
5 MR. INGRAM:
6 Vander Weide, Dr. Vander Weide? Yes.
7 MR. BARBERIE:
8 . . . Vander Weide?
9 MR. INGRAM:
10 I'll be glad to announce those.
11 CHAIRMAN GOSS:
12 Okay.
13 MR. SPENARD:
14 With regard to Mr. Jarrett, I'm looking at our
15 questions for him, and I know that one other
16 party has indicated. It's a suggestion or it's an
17 offer that, because we only have three and I'm not
18 sure that we need to ask these, because I think
19 they've otherwise been covered or will be covered,
20 perhaps we could get with Staff and we could get
21 him today. We're basically prepared to move on
22 and say that we think that our questions to
23 Jarrett have been covered or will be covered and,
24 depending on the length of questions by the LFUCG,
25 it might be possible to move Mr. Jarrett through,

1 and we would have no objection to that.

2 CHAIRMAN GOSS:

3 Well, I appreciate that. Quite frankly, I have
4 something over in Lexington that I need to try to
5 get over to by about five-fifteen, and I'm going
6 to be pushing it to get that done, and I'm just
7 trying to get an idea about whether or not you
8 gentlemen believe that we will be able to get
9 finished tomorrow afternoon. We can go - is there
10 any reason we can't go a little bit later
11 tomorrow?

12 MR. INGRAM:

13 I would be real surprised, if we start at nine
14 tomorrow, if we don't finish before five o'clock
15 tomorrow.

16 CHAIRMAN GOSS:

17 Oh, you think we can?

18 MR. HOWARD:

19 Mr. Chairman, . . .

20 MR. INGRAM:

21 I think we can. Sure.

22 MR. HOWARD:

23 I'm sorry, Mr. Ingram. I didn't hear from Mr.
24 Wuetcher insofar as his questions for Ms. Crane.
25 Do you expect to have very many, or . . .

1 MR. WUETCHER:

2 We have some, but, if necessary, we can modify
3 our questions to make sure we get the most
4 pertinent ones. So I don't . . .

5 CHAIRMAN GOSS:

6 Well, I don't want anybody to modify anything.
7 I want to give everybody . . .

8 MR. WUETCHER:

9 Well, no, sir. I don't see any reason why we
10 would not be able to get finished by tomorrow.

11 CHAIRMAN GOSS:

12 Okay.

13 MR. HOWARD:

14 And that's why I was asking him, . . .

15 CHAIRMAN GOSS:

16 Sure. I understand.

17 MR. HOWARD:

18 . . . because, with that series in mind, I think
19 that we can complete by five.

20 CHAIRMAN GOSS:

21 I appreciate that, Mr. Howard, and, if we don't
22 finish, if we don't get finished tomorrow, that's
23 fine except that Thursday is a State holiday and
24 we will not have anybody here and we would need to
25 go into Friday, which would not be a problem

1 because we have, I think, Friday set aside. So
2 let's try to get finished tomorrow if we can. If
3 we can't, fine. We'll go on into Friday, but I
4 just wanted you gentlemen to be thinking about
5 that in terms of trying to coordinate your further
6 questioning. Okay. Mr. Ingram, did you want to
7 tell me something about Dr. - is it Dr. Vander
8 Weide or Mr. Vander Weide?
9 MR. INGRAM:
10 It is Dr. Vander Weide. I can't remember. I
11 think it's Norwegian, but, in any event . . .
12 CHAIRMAN GOSS:
13 He and Mr. Svindland probably are cousins.
14 MR. INGRAM:
15 I spoke with him and his wife at the break. I
16 inferred that the surgery Thursday was a little
17 more than anybody expected, but he is recovering
18 well. He told me he's getting his strength back
19 daily. He certainly anticipated that he would be
20 able to be cross examined by video next week. His
21 doctor told him it would be a minimum of two weeks
22 and the doctor thought two to three weeks before
23 he could travel. His wife is in the process
24 forthwith of trying to find a video terminal
25 service or several in Durham. As soon as she can

1 give me the telephone numbers, if it's
2 appropriate, I'll either call Mr. Wuetcher or some
3 other appropriate person here to see about the fit
4 of the technology and we can . . .

5 CHAIRMAN GOSS:

6 Okay. Does it have to be videoed?

7 MR. INGRAM:

8 Well, I guess the option would be to cross examine
9 him by telephone and that, I think, was frowned
10 upon by some of the lawyers in the case earlier.

11 CHAIRMAN GOSS:

12 Okay. Okay. That's fine.

13 MR. WUETCHER:

14 Your Honor, as soon as we have that information,
15 I've spoken with our Information Technology people
16 here, and the Commission has done video
17 conferencing testimony in one other instance.
18 We're not - we do not have - we had results that
19 were less than desirable, so we need to do a
20 little bit of testing prior to make sure the
21 arrangement can be done, but we believe we can do
22 that by next week.

23 CHAIRMAN GOSS:

24 Oh, I see. You anticipate hooking him up right
25 here, right here in the hearing room for everyone

1 to see rather than doing a video deposition?
2 MR. INGRAM:
3 Yes. He'll be in Durham and, hopefully, we'll be
4 able to see him live and people can cross examine
5 him.
6 MR. WUETCHER:
7 Yes, sir.
8 MR. INGRAM:
9 That's the goal.
10 CHAIRMAN GOSS:
11 Okay.
12 MR. INGRAM:
13 And I think those places are available
14 commercially and otherwise and efforts are
15 underway to see about doing it.
16 CHAIRMAN GOSS:
17 If they don't have one in Durham, North
18 Carolina, I'd be surprised.
19 COMMISSIONER COKER:
20 Exactly. Universities have it.
21 CHAIRMAN GOSS:
22 Yeah. Okay. Is there anything else to take up?
23 I said we'd go to five everyday and I've violated
24 my own rule the first two days of the hearing.
25 We'll try to . . .

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MR. INGRAM:

But the king can violate his own rules.

CHAIRMAN GOSS:

Yeah. Well, I guess. I've been called a lot of things, Mr. Ingram, but never a king. Okay. If there's nothing else to take up, thank you all very much, and we'll be adjourned until in the morning at nine o'clock.

HEARING CONTINUED
OFF THE RECORD

1 STATE OF KENTUCKY
2 COUNTY OF FRANKLIN

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I, Connie Sewell, the undersigned Notary Public, in and for the State of Kentucky at Large, do hereby certify the foregoing transcript is a complete and accurate transcript, to the best of my ability, of the hearing taken down by me in this matter, as styled on the first page of this transcript; that said hearing was first taken down by me in shorthand and mechanically recorded and later transcribed by me; that the witnesses were first duly sworn before testifying.

My commission will expire November 19, 2005.

Given under my hand at Frankfort, Kentucky, this the 1st day of December, 2004.

Connie Sewell

Connie Sewell, Notary Public
State of Kentucky at Large
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