COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:	)	
	)	
NOTICE OF ADJUSTMENT OF THE RATES OF	)	**CASE NO. 2007-00143**
KENTUCKY-AMERICAN WATER COMPANY	)	
EFFECTIVE ON AND AFTER MAY 30, 2007	)	

DIRECT TESTIMONY OF SHEILA A. MILLER

April 30, 2007

KENTUCKY AMERICAN WATER COMPANY
CASE NO. 2007-00143
Direct Testimony
Sheila A. Miller

1. Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS FOR THE RECORD.

A. My name is Sheila A. Miller and my business address is 1600 Pennsylvania Avenue, Charleston, West Virginia 25302.

2. Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by the American Water Service Company, Inc. ("Service Company") as Assistant Manager Rates and Regulation for the Southeastern Regional Service Company Office.

3. Q. PLEASE ELABORATE UPON YOUR DUTIES AS SENIOR FINANCIAL ANALYST FOR THE SOUTHEASTERN REGIONAL SERVICE COMPANY.

A. My responsibilities include the preparation and presentation of rate filings requested by three operating companies comprising the Southeastern Region of American Water. I am also responsible for various accounting duties including budget preparation, account reconciliation, and financial statement analysis.

4. Q. HAVE YOU PREVIOUSLY PARTICIPATED IN REGULATORY MATTERS?

A. Yes, I have prepared rate cases and presented testimony before the Kentucky Public Service Commission, Tennessee Regulatory Authority and the State Corporation Commission of Virginia. I have also worked on the preparation of exhibits and data requests for West Virginia American.

5. Q. WOULD YOU PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND BUSINESS EXPERIENCE?

A. Yes. In 1983, I graduated Summa Cum Laude with a Bachelor of Arts degree from Glenville State College with a major in Accounting and Management, and a minor in Economics. In 1988, I received my Certified Public Accountant license.

I have worked with the American System for 23 years and began my career in December 1984, as a Junior Accountant. In that capacity I worked in the Construction Accounting Department for the Service Company.

I assisted with the system-wide acquisition integration of Citizens Water by serving on the Acquisition Team. I also participated in the set up of the system-wide conversion process for the Shared Services Center by assisting Information Services with reporting processes.

Throughout the years, I have moved through the ranks of the financial side of the business from Accountant in 1985, Construction Accounting Supervisor for the Southeast Region in 1988, Construction Accounting Superintendent for West Virginia American Water Company in 1992, Assistant Director of Accounting for West Virginia American in 1995, Director of Accounting for West Virginia American in 1997, Director of Accounting for the Southeast Region in 2000, and due to the reorganization of the Shared Services Center, I was transferred to Senior Financial Analyst for the Southeast Region in 2002. In 2007 I was promoted to Assistant Manager Rates and Regulation. I have significant knowledge and expertise in accounting and other financial aspects of American Water, including Kentucky American Water.

6. Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS CASE?

The purpose of my testimony is to support the Company's adjustments to forecasted Purchased Water, Group Insurance, Regulatory Expense, Insurance Other than Group, Customer Accounting, Rents, General Office Expense, Miscellaneous Expense, and General Taxes. I will discuss the Rate Base for rate recovery and I will also address the Filing Requirements and the General Rate Case Structure.

7. Q. WHAT IS THE AMOUNT OF THE REVENUE INCREASE THAT THE COMPANY IS REQUESTING?

A. The Company is requesting an overall revenue increase of $13,188,906 or 25.10%. Under single-tariff pricing, which the company is seeking in this rate filing, the Central Division is seeking a revenue increase of $13,654,999 or 26.94%, Tri Village is seeking a decrease of $367,028 or (31.53%), Elk Lake is seeking an increase of $42 or .04%, and Owenton is seeking a decrease of $99,143 or (16.37%). On a stand alone basis, the Central Division would be seeking a revenue increase of $11,670,749 or 23.03%, Tri Village would be seeking an increase of $736,553 or 63.27%, Elk Lake would be seeking an increase of $53,413 or 57.04%, and Owenton would be seeking an increase of $728,191 or 120.25%.

8. Q. WHAT IS THE TEST PERIOD REFLECTED IN THIS CASE?

A. The Company has used a forecasted test period of the twelve months ending November 30, 2008 and a base period of twelve months ended July 31, 2007. The base period data reflects six months of actual data and six months of forecasted data.

9. Q. MRS. MILLER, WHAT GUIDELINES HAS THE COMPANY FOLLOWED IN ADJUSTING THE BASE PERIOD DATA?

A. The Company has adjusted its base period revenues, expenses, rate base and capitalization to reflect these items based on a forecasted test period ending November 30, 2008. The Company has utilized the same guidelines in developing its forecasted test period as it uses in its budgeting process. These guidelines are designed to reflect, as accurately as possible, the Company's need to operate and maintain its assets, provide quality service to its customers and provide a reasonable return to its stockholder.

10. Q. MRS. MILLER, WOULD YOU PLEASE SUMMARIZE THE COMPANY'S RATE FILING?

A. Yes. As noted earlier, the Company is filing this application for an increase in rates based upon a fully forecasted test period of 12 months ending November 30, 2008 as currently allowed by 807 KAR 5:001 Section 10b. The Commission has outlined various filing requirements concerning a forecasted test period. The Company's filing is supported by a series of 37 exhibits. We have segregated the filing into four districts including the Central Division which includes Bourbon, Clark, Fayette, Harrison, Jessamine, Scott, and Woodford Counties, and three districts within the Northern Division which include Tri Village, Elk Lake, and Owenton. The allocation of direct and indirect costs between these divisions will be discussed in the testimony of Mr. Michael Miller.

11. Q. MRS. MILLER, ARE THERE ANY EXHIBITS YOU WISH TO COMMENT ON BEFORE YOU CONTINUE?

A. Yes. I would like to briefly discuss Exhibit 37. Exhibit 37 represents the standard schedules required by the Commission when a utility files a general adjustment in rates supported by a forecasted test period. This exhibit contains 14 schedules identified as Schedules A through N. I would like to identify each schedule.

Schedule A is a jurisdictional financial summary for both the base period and the forecasted period, which details how the utility derived the amount of the requested revenue increase.

Schedule B is a jurisdictional rate base summary for the base period and the forecasted period with the supporting schedules, which include detailed analysis of each component of rate base.

Schedule C is a jurisdictional operating income summary for the base period and the forecasted period with supporting schedules that are broken-down by major account group and by individual account.

Schedule D is a summary of jurisdictional adjustments to operating income by major account with supporting schedules for individual adjustments and jurisdictional factors.

Schedule E is the jurisdictional federal and state income tax summary for the base period and the forecasted period with supporting schedules of the various components of jurisdictional income taxes.

Schedule F contains summary schedules for the base period and the forecasted period of organization membership dues, initiation fees, expenditures at country clubs, charitable contributions, marketing, sales, and advertising expenditures; professional service expenses; civic and political expenses; expenditures for employee awards functions and outings; employee gift expenses; and rate case expenses.

Schedule G is an analysis of payroll costs including schedules for wages and salaries, employee benefits, payroll taxes, straight time and overtime hours, and executive compensation.

Schedule H is a computation of the gross revenue conversion factor for the forecasted period.

Schedule I provides comparative income statements, revenue statistics and sales statistics for the five most recent calendar years from the application filing date, the base period, the forecasted period, and two calendar years beyond the forecast period.

Schedule J provides a cost of capital summary for both the base period and forecasted period and supporting schedules providing detail on each component of the capital structure.

Schedule K provides comparative financial data and earnings measures with the 10 most recent calendar years, the base period and the forecasted period.

Schedule L provides a narrative explanation of all proposed tariff changes.

Schedule M provides a revenue summary for both the base period and forecasted period with supporting schedules, which provide detailed billing analyses for all customer classes.

Schedule N provides a typical bill comparison of the present and proposed rates for all customer classes.

12. Q. WHAT IS THE SOURCE OF THE INFORMATION CONTAINED ON THE EXHIBITS 1 THROUGH 37 AND SCHEDULES MARKED A THROUGH N UNDER EXHIBIT 37?

A. The information utilized in all exhibits and schedules was taken from the books and records of the Company or from information provided to me and other Company witnesses and by management of the Company. Each schedule is referenced to a supplementary schedule or work paper, where appropriate, which was used to develop the Exhibit 37. Each schedule also identifies a witness or witnesses who will be responsible for responding to questions concerning information on the schedule.

OPERATION & MAINTENANCE EXPENSES

13. Q. PLEASE EXPLAIN THE CALCULATIONS OF THE FORECASTED LEVEL OF PURCHASED WATER EXPENSE.

The Company purchases water from Winchester Municipal Utilities (WMU) for Central Division customers in Clark County. The Agreement with WMU to purchase water expires October 13, 2021. The Company also purchases water from Georgetown Municipal Water and Sewer System (GMWSS) for water sold in Owen County. Additional purchases for the Northern Division are made from Carroll and Gallatin Counties. In addition, there are inter-company arrangements where water from Owenton is purchased. The need for this time-consuming accounting for inter-company sales and purchased water will not be required if single tariff pricing is approved. The forecasted Purchased Water Expense was estimated based on the actual usage during 2006 and applying the appropriate cost rate per cubic feet. Purchased water expense for the forecasted test year is $477,463.

14. Q. HOW DID THE COMPANY CALCULATE ITS GROUP INSURANCE EXPENSE?

A. The total group insurance expense for the forecasted test year is $1,888,102. This expense is comprised of 1) current group insurance costs for current associates and 2) post retirement employee benefits costs (OPEB's) for both its current employees and its retired employees.

The OPEB's expense is based on projections provided by the actuarial firm of Towers Perrin.

The current group insurance costs reflect the use of the Company's current group insurance premium statement rates and adjusted to reflect an 8% increase effective January 1, 2008. These rates were then applied to the current coverage levels for the full time employees included in the Company's case.

The Company provides its current associates with life insurance, group medical insurance, prescription drug, accidental death, accident, sickness and disability coverage. The current group insurance coverage rates were effective January 1, 2007.

15. Q. WHAT ARE REGULATORY COMMISSION EXPENSES?

A. Regulatory expenses are estimated costs incurred for preparing and litigating this case, including studies and investigations. We are requesting a three-year amortization of rate case expense.

16. Q. HOW WAS KENTUCKY AMERICAN WATER'S LEVEL OF INSURANCE OTHER THAN GROUP EXPENSE CALCULATED?

A. KAW's level of insurance other than group is based on the most current annual premiums. Insurance other than group includes payments for insurance to cover such items as excess general liability, property liability, fiduciary liability, commercial crime coverage, flood liability and worker's compensation.

17. Q. PLEASE DISCUSS KENTUCKY AMERICAN WATER'S FORECASTED LEVEL OF CUSTOMER ACCOUNTING EXPENSE.

A. KAW's customer accounting expense includes costs for such items as postage, telephone, forms utilized for customer service and billings, uncollectible accounts and collection agencies. This is not a complete listing but it does represent most of the larger dollar items in this expense. In comparison, our forecast is slightly above the amount experienced in the base period. The forecast reflects an expense of $1,461,534 for customer accounting costs.

18. Q. CAN YOU PLEASE DESCRIBE WHAT ITEMS ARE INCLUDED IN RENT EXPENSE?

A. KAW's forecast for rent expense is based upon signed agreements and anticipated agreements. These agreements cover such items as copiers and a postage machine. These items were all included in KAW's previous rate case.

19. Q. PLEASE EXPLAIN WHAT ITEMS ARE INCLUDED IN THE GENERAL OFFICE CATEGORY.

A. Items in this category include dues and memberships, employee travel and meal expenses, office supplies, and general office utility costs. The Company's forecasted expense is $475,196. This amount is below the base period expense amount and slightly higher than 2006.

20. Q. WHAT IS INCLUDED IN THE CATEGORY OF MISCELLANEOUS EXPENSES?

A. Included in this category are various expense items that are incurred throughout the year that are a part of carrying out of normal business functions. Included in this category are costs for services such as janitorial, legal, advertising, employee training programs, uniforms, telephone and some amortizations. Also included are expenditures related to conservation and security services.

GENERAL TAXES

21. Q. PLEASE DISCUSS EACH COMPONENT OF THE COMPANY'S FORECASTED LEVEL FOR GENERAL TAXES.

A. The first component that I will discuss is property taxes. The Company's forecasted level of property tax is $3,054,079. It is based upon a ratio of the actual 2006 tax payments to the applicable total tax base as of December 31, 2005. The rate of $1.0963 per $100 of property was applied to the actual tax base of December 31, 2006 and to the projected tax base of December 31, 2007 to arrive at a forecasted property tax expense for the 12-months ended November 30, 2008.

The second component of General Taxes is the Public Service Commission Fee. The Company has forecasted its Public Service Commission (PSC) fee for the forecasted test period by arriving at an average PSC fee rate of .1680%. The percent was calculated by dividing the actual tax payments for 2004-2006 by their associated revenues and then calculating a three-year average PSC fee rate. By applying this three-year average PSC fee rate to the total forecasted revenues, less AFUDC, the Company's forecasted level of PSC fee is $85,164 at present rates.

The final component of General Taxes is payroll taxes. The Company has forecasted its payroll tax expense based upon the forecasted level of labor costs. For FICA taxes, the rate used was 6.2% on a base of $101,000 and a Medicare tax rate of 1.45% on all wages. Federal unemployment is calculated based upon a tax rate of .8% and a base of $7,000. State unemployment tax of .5% is calculated on a base of $8,000. These tax rates and bases were then applied to the total forecasted level of labor cost with amounts being expensed and capitalized. The Company's total forecasted level of payroll tax expense is $487,918.

Total forecasted General Taxes is $3,627,161 at present rates.

RATE BASE

22. Q. MRS. MILER, HOW DID THE COMPANY DEVELOP ITS FORECASTED LEVEL OF RATE BASE OF $211.572 MILLION AS SHOWN ON SCHEDULE B-1, PAGE 2 OF 2?

A. The Company developed its rate base by using a 13-month average for most of the items shown on Schedule B-1, page 2 of 2. Some of the elements were calculated using a 24-month average based on the Commission's final order in Case No. 97-034. Many of the rate base elements shown on this schedule, i.e., utility plant in service, accumulated depreciation, customer advances, etc. were analyzed from actual per books data as of January, 2007. Using data and projections for each of the rate base elements, the Company developed a 13-month average for the forecasted test period ending November 30, 2008.

23. Q. PLEASE DESCRIBE HOW THE 13-MONTH AVERAGE FOR THE UTILITY PLANT IN SERVICE (UPIS) WAS CALCULATED?

A. The starting point for the calculation of the 13-month average for utility plant in service was the actual level as of January 2007. From that point through the end of the test period, the Company has forecasted capital expenditures by month for investment projects 80 through 97 (normal recurring plant investment) and for special Investment Projects (IP) that are related to larger, specific capital investment projects. These capital expenditures have been approved by the Company's Board of Directors. The forecasted expenditures for all projects were slotted by month based upon the expected cash flow of each project. When the project is complete, all expenditures related to that project will be placed into service. Therefore, the 13-month average of forecasted utility plant in service only reflects the inclusion of projects when they are complete and in service.

The Company also projects utility plant retirements by month. These retirements were deducted from the balance of utility plant in service in the month in which the retirement is expected to occur. Ms. Bridwell will be discussing in further detail in her testimony the Company's planned capital investment program for 2007 and 2008. The total 13-month average forecasted level of Utility Plant in Service is $366.185 million.

24. Q. PLEASE DISCUSS THE REMAINING RATE BASE ELEMENTS ON SCHEDULE B-1, PAGE 2 OF 2.

A. Rate Base - Utility Plant Acquisition Adjustment (UPAA)

The next rate base element as shown on Schedule B-1, page 2 of 2 is utility plant acquisition adjustments. The actual balance in the account as of January, 2007 was $55,466. The UPAA relates to the Acquisition of the Boonesboro Water Association. The Company is using a 10-year amortization based on prior Commission treatment of UPAA for Boonesboro. The level included in the 13-month average rate base calculation (net of amortizations) for the UPAA in rate base is $38,065 which includes only Boonesboro.

Rate Base - Accumulated Depreciation

The next rate base element as shown on Schedule B-1, page 2 of 2 is accumulated depreciation. The accumulated depreciation was developed in the same manner as the utility plant in service. The actual balance as of January, 2007 was used as a starting point. This balance was adjusted for forecasted depreciation expense by month, and forecasted retirements by month. The depreciation rates used to develop this item of rate base were those resulting from the depreciation study prepared by Mr. John Spanos. Mr. Spanos will discuss the depreciation study in his direct testimony. The accumulated reserve for depreciation was developed by month by account from November 2007 through November 2008, with a 13-month average balance of $85.951 million being deducted from rate base.

Rate Base - Accumulated Amortization

The next rate base element as shown on Schedule B-1, page 2 of 2 is for the Company's franchise expense. The actual balance is $7,674 and is being deducted from rate base.

Rate Base - Construction Work in Progress (CWIP)

The next rate base element as shown on Schedule B-1, page 2 of 2 is Construction Work in Progress. The Company is proposing to include in its 13-month average rate base a level of CWIP for the forecasted test period. The 13-month average is $23.187 million. This amount is based on the actual balance as of January 2007, adding forecasted expenditures by month and then deducting amounts transferred to Utility Plant in Service. The forecasted expenditures for all projects were taken from the approved capital expenditures plan and were slotted by month based on expected cash flow. When a project (work order) is complete and in service, the dollars are transferred from CWIP to UPIS.

25. Q. MRS. MILLER, THE RATE BASE ELEMENT AS SHOWN ON SCHEDULE B-5, PAGE 2 OF 2 IS THE WORKING CAPITAL ALLOWANCE. WHAT IS WORKING CAPITAL AND WHAT METHOD DID THE COMPANY USE IN CALCULATING ITS WORKING CAPITAL ALLOWANCE IN THE CASE?

A. Working capital is a rate base element that recognizes the amount of investor supplied funds that are used to fund the day to day operation of the Company and to recognize the delay in the recovery of certain expenses from the ratepayers. The Company is using a lead/lag study that was prepared in Case No. 2004-00103 and made two adjustments. We adjusted the accounts receivable lag and the billing lag to reflect the most current information. All other elements remained the same. The Company is proposing a working capital allowance of $4.927 million.

26. Q. PLEASE CONTINUE WITH YOUR DISCUSSION OF RATE BASE.

A. <u>Rate Base - Contributions in Aid of Construction</u>

The next rate base element as shown on Schedule B-1, page 2 of 2 is Contributions In Aid of Construction (CIAC). Again, this element was developed by starting with the actual balance as of January, 2007. The Company has forecasted an increase in these contributions based upon either:

1) Direct contributions from developers, businesses or government agencies.
2) Increases in CIAC as a result of transfers from Customer Advances after 10-year agreements expire.

The 13-month average balance was developed by analyzing the forecasted activity in the CIAC accounts beginning with November, 2007 through November, 2008 resulting in a forecasted 13-month average balance of $46.563 million.

The Company's forecasted CIAC balance includes the impact of the Company's proposed revision to the tap fee tariff. The revised tap fee tariff is found under Exhibit 2 of the Company's filing.

The revised tap fee tariff indicates the Company will collect from developers or other parties $660 for residential service, $1,254 for 1" service, and $2,945 for 2" service, all of which are based on a 3-year average of actual costs to install these services and the cost of a meter. The tap fees for services over 2" are based on the actual cost of installation.

The Company forecasts collection of CIAC from the revised tap fee tariff of $1.966 million, an increase over 2006 levels, and the increased amount would become effective when the results of this case are final and the revision is approved by the Commission. Ms. Bridwell will discuss the calculation of the proposed revision to the tap fee tariff in her direct testimony.

<u>Rate Base - Customer Advances</u>

The next rate base element is customer advances. The 13-month balance for customer advances was developed in the same manner as were CIAC's. The

Company forecasted receipts and refunds of customer advances and transfer of customer advances to the contributions account by month through the end of the forecasted test period, thus resulting in a 13-month average balance of $21.381 million for the forecasted test period. These forecasted receipts are based on management discussions with local developers and refunds are based on a review of historical trends in this category.

Rate Base - Deferred Income Taxes

Deferred Income Taxes are included in rate base as a reduction to the forecasted 13-month average rate base. The forecasted amount in rate base is $30.854 million. The forecasted amount is shown on Schedule B-1, page 2 of 2 and further detailed on B-6, page 2 of 2 and in the workpapers. There are Deferred Taxes associated with UPIS, Deferred Maintenance, and Deferred Debits. All of these items have been recognized by the Commission in prior cases.

In this rate case the Company has incorporated SFAS 109 – Accounting for Income Taxes. Both the rate base reduction for income taxes and the calculation of forecasted federal and state income tax expense is based on SFAS 109.

Rate Base - Deferred Investment Tax Credit

The next rate base element is deferred investment tax credit. The Company is currently amortizing its 3% deferred investment tax credit (pre-1971). The actual balance of the 3% deferred investment tax credit as of the end of January, 2007 was $108,841. The forecasted monthly amortization is applied, producing a forecasted test-year, 13-month average balance of $94,805 which is being deducted from rate base.

Rate Base-Deferred Maintenance

The next rate base element is deferred maintenance. The Company has developed a 13-month average of deferred maintenance projects based upon both actual projects deferred and projects forecasted to be deferred. These projects include the repainting and repairs of system water storage tanks, and other major repairs of pumps and traveling screens as shown in the workpapers that support Schedule B. There are three tank paintings scheduled for completion in 2007 at a cost of $719,400 that have not previously been approved for amortization by the Commission. Based upon these actual expenditures and the forecasted expenditures for 2007 and 2008, as adjusted for amortizations, the Company has developed a 13-month average of these deferred maintenance items totaling $1.741 million.

Rate Base - Deferred Debits

The Company is requesting a rate base addition of $1.898 million for various deferred debit items. These amounts are offset by their applicable deferred taxes discussed earlier. The Company developed its 13-month average addition to rate base for items both deferred and recognized in prior cases by the Commission. There are no new deferred items being requested in the current case.

27. Q. MRS. MILLER, PLEASE CONTINUE WITH THE NEXT RATE BASE ELEMENT SHOWN ON SCHEDULE B-1, PAGE 2 OF 2.

A. The next Rate Base element is titled Other Rate Base elements which is comprised of five items as discussed below:

Rate Base – Other Rate Base Elements

In the last rate case, the Commission reduced rate base for Contract Retentions, Unclaimed Extension Deposit Refunds, Retirement Work in Progress, Deferred Compensation and Accrued Pension. The Company has calculated a rate base reduction of $1.553 million for these items based on the Commission's Order in Case No. 2004-00103.

28. Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.