Response of Michael J. Majoros, Jr.

1. Refer to Direct Testimony of Michael J. Majoros, Jr., Exhibit MJM-1, Schedule 2. Explain why this schedule does not contain any adjustment to forecasted Allowance for Funds Used During Construction ("AFUDC") revenue included above the line of $1,858,197 to account for Dr. Woolridge's adjustments to Kentucky-American Water Company's ("Kentucky-American") return on common equity.

Response:

Mr. Majoros is providing a revised proposal to incorporate this adjustment. The Company's calculation of the $1,858,197 in AFUDC revenue is shown in KAW_R_AGDR1#46_const_061807.xls. Mr. Majoros has changed KAWC's Proposed Book AFUDC Rate (cell P3) from 8.64% to Dr. Woolridge's recommended 7.77%. This caused the total AFUDC revenue to decrease to $1,672,308 (cell AH271). KAWC used 6.30% as both the current and proposed Tax AFUDC rate. Because the Company did not change this rate, Mr. Majoros believes it is the correct rate to use for his calculation as well.

Please see Exhibit___(MJM-4) Updated, Schedule 9 for Adjustment 11, which is the AG's new AFUDC adjustment. Adjustment 11 is carried forward to Exhibit___(MJM-1) Updated, Schedule 2. Both exhibits are attached to these responses.

KENTUCKY AMERICAN WATER COMPANY
FUTURE TEST YEAR ENDING NOVEMBER 30, 2008

AG Adjustment No. 11 (Update)

Adjust AFUDC Revenue for Recommended 7.77% ROE

Line	Description		Amount	
1	Company AFUDC Revenue above the line	$	1,858,197	1/
2	Less: AFUDC Revenue adj. for 7.77 ROE		1,672,308	2/
3	Difference (L. 1 - L. 2)		185,889	
4	Adjustment - Pre Tax	$	(185,889)	
5	Tax Rate		38.90%	
6	Tax Effect (L. 4 * L. 5)	$	(72,311)	
7	Adjustment - Post Tax (L. 4 - L. 6)	$	(113,578)	
8	Revenue Conversion Factor		1.65249	
9	Revenue Requirement (L. 7 * L. 8)	$	(187,687)	

Sources:

1/ KAWC Schedule D-1, p. 1 of 19.
2/ KAW_R_AGDR1#46_const_061807.xls, AFUDC tab, with proposed book AFUDC rate set to 7.77%.

KENTUCKY-AMERICAN WATER COMPANY

SUMMARY OF ATTORNEY GENERAL ADJUSTMENTS

Line No.	Major Group Classification	Company Forecasted Revenues & Expenses	AG Adj. 1 Depreciation Impact on Ratebase	AG Adj. 2 Cash Working Capital	AG Adj. 3 Consolidated Taxes	AG Adj. 4 Excess Management Fees	AG Adj. 5 Depreciation Expense	AG Adj. 6 Incentive Pay	AG Adj. 7 Group Insurance	AG Adj. 8 Bus. Devel. Portion of Mgmt. Fees	AG Adj. 9 Wastewater Technician	AG Adj. 10 Interest Synchronization	Total AG Original Adjustments
1													
2	**Operating Revenues**												
3	Water Sales	$ 49,242,905	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
4	Other Operating Revenues	3,760,392	-	-	-	-	-	-	-	-	-	-	-
5		$ 53,003,297	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
6	**Operating Expenses**												
7	Labor	$ 6,248,477	$ -	$ -	$ -	$ -	$ -	$ (252,550)	$ -	$ -	$ (12,497)	$ -	$ (265,047)
8	Purchased Water	477,463	-	-	-	-	-	-	-	-	-	-	-
9	Fuel and Power	2,986,277	-	-	-	-	-	-	-	-	-	-	-
10	Chemicals	1,505,218	-	-	-	-	-	-	-	-	-	-	-
11	Waste Disposal	262,237	-	-	-	-	-	-	-	-	-	-	-
12	Management Fees	6,201,194	-	-	-	(922,871)	-	-	-	(79,365)	-	-	(1,002,236)
13	Group Insurance	1,876,895	-	-	-	-	-	-	(114,696)	-	-	-	(114,696)
14	Pensions	502,684	-	-	-	-	-	-	-	-	-	-	-
15	Regulatory Expense	292,195	-	-	-	-	-	-	-	-	-	-	-
16	Insurance Other than Group	663,910	-	-	-	-	-	-	-	-	-	-	-
17	Customer Accounting	1,376,372	-	-	-	-	-	-	-	-	-	-	-
18	Rents	52,165	-	-	-	-	-	-	-	-	-	-	-
19	General Office Expense	475,196	-	-	-	-	-	-	-	-	-	-	-
20	Miscellaneous	3,002,289	-	-	-	-	-	-	-	-	-	-	-
21	Maintenance - Other	1,507,210	-	-	-	-	-	-	-	-	-	-	-
22													
23	Total O & M Expenses	$ 27,429,783	$ -	$ -	$ -	$ (922,871)	$ -	$ (252,550)	$ (114,696)	$ (79,365)	$ (12,497)	$ -	$ (1,381,979)
24													
25	Depreciation	$ 8,038,653	$ -	$ -	$ -	$ -	$ (416,463)	$ -	$ -	$ -	$ -	$ -	$ (416,463)
26	Amortization	450,971	-	-	-	-	-	-	-	-	-	-	-
27													
33	Total General Taxes	3,297,769	-	-	-	-	-	-	-	-	-	-	-
34													
42	Total Income Taxes	2,980,507	-	-	(894,416)	358,997	162,004	98,242	44,617	30,873	4,861	13,772	(181,050)
43													
44													
45	Total Operating Expenses	$ 42,197,683	$ -	$ -	$ (894,416)	$ (563,874)	$ (254,459)	$ (154,308)	$ (70,079)	$ (48,492)	$ (7,636)	$ 13,772	$ (1,979,492)
46													
47	Utility Operating Income	$ 10,805,614	$ -	$ -	$ 894,416	$ 563,874	$ 254,459	$ 154,308	$ 70,079	$ 48,492	$ 7,636	$ (13,772)	$ 1,979,492
48													
49													
50	Rate Base	$202,100,690	$ 413,549	$ (269,000)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 144,549
51													
52	KAWC Proposed ROR	8.64%											
53													
54	AG Recommended ROR	7.77%	7.77%	7.77%									
55													
56	NOI Effect	$ (1,758,276)	$ 32,133	$ (20,901)									
57													
58	KAWC Revenue Conversion Factor												
59													
60	AG Revenue Conversion Factor	1.65249	1.65249	1.65249	-1.65249	-1.65249	-1.65249	-1.65249	-1.65249	-1.65249	-1.65249	-1.65249	
61													
62	Incremental Revenue Requirement	$ (2,905,537)	$ 53,099	$ (34,539)	$ (1,478,016)	$ (931,798)	$ (420,492)	$ (254,993)	$ (115,805)	$ (80,133)	$ (12,618)	$ 22,759	$ (6,158,073)

Note: Difference from Schedule 1 due to rounding.

KENTUCKY-AMERICAN WATER COMPANY

SUMMARY OF ATTORNEY GENERAL ADJUSTMENTS

Line No.	Major Group Classification	Company Forecasted Revenues & Expenses	Additional Adjustments For Update: AG Adj. 11 AFUDC	AG Adj. 12 Uncollectibles Expense	AG Adj. 13 Memberships	AG Adj. 14 Additional Cash Working Capital	AG Adj. 15 Additional Interest Synchronization	Total AG Additional Adjustments	Total AG Adjustments	AG Updated Recommended Revenues and Expenses
1										
2	**Operating Revenues**									
3	Water Sales	$ 49,242,905	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 49,242,905
4	Other Operating Revenues	3,760,392	(185,889)	-	-	-	-	(185,889)	(185,889)	3,574,503
5		$ 53,003,297	$ (185,889)	$ -	$ -	$ -	$ -	$ (185,889)		$ 52,817,408
6	**Operating Expenses**									
7	Labor	$ 6,248,477	$ -	$ -	$ -	$ -	$ -	$ -	$ (265,047)	$ 5,983,430
8	Purchased Water	477,463	-	-	-	-	-	-	-	477,463
9	Fuel and Power	2,986,277	-	-	-	-	-	-	-	2,986,277
10	Chemicals	1,505,218	-	-	-	-	-	-	-	1,505,218
11	Waste Disposal	262,237	-	-	-	-	-	-	-	262,237
12	Management Fees	6,201,194	-	-	-	-	-	-	(1,002,236)	5,198,958
13	Group Insurance	1,876,895	-	-	-	-	-	-	(114,696)	1,762,199
14	Pensions	502,684	-	-	-	-	-	-	-	502,684
15	Regulatory Expense	292,195	-	-	-	-	-	-	-	292,195
16	Insurance Other than Group	663,910	-	-	-	-	-	-	-	663,910
17	Customer Accounting	1,376,372	-	(29,544)	-	-	-	(29,544)	(29,544)	1,346,828
18	Rents	52,165	-	-	-	-	-	-	-	52,165
19	General Office Expense	475,196	-	-	-	-	-	-	-	475,196
20	Miscellaneous	3,002,289	-	-	(3,386)	-	-	(3,386)	(3,386)	2,998,903
21	Maintenance - Other	1,507,210	-	-	-	-	-	-	-	1,507,210
22									-	
23	Total O & M Expenses	$ 27,429,783	$ -	$ (29,544)	$ (3,386)	$ -	$ -	$ (32,930)		$ 26,014,874
24										
25	Depreciation	$ 8,038,653	$ -	$ -	$ -	$ -	$ -	$ -	$ (416,463)	$ 7,622,190
26	Amortization	450,971	-	-	-	-	-	-	-	450,971
27										
33	Total General Taxes	3,297,769	-	-	-	-	-	-	-	3,297,769
34										
42	Total Income Taxes	2,980,507	(72,311)	11,493	1,317	-	1,768	(57,733)	(238,783)	2,741,724
43										
44										
45	Total Operating Expenses	$ 42,197,683	$ (72,311)	$ (18,051)	$ (2,069)	$ -	$ 1,768	$ (90,663)	$ (655,246)	$ 40,127,528
46										
47	Utility Operating Income	$ 10,805,614	$ (113,578)	$ 18,051	$ 2,069	$ -	$ (1,768)	$ (95,226)	$ 655,246	$ 12,689,880
48										
49										
50	Rate Base	$202,100,690	$ -	$ -	$ -	$ (131,000)	$ -	$ (131,000)	$ 13,549	$ 202,114,239
51										
52	KAWC Proposed ROR	8.64%								
53										
54	AG Recommended ROR	7.77%				7.77%				
55										
56	NOI Effect	$ (1,758,276)				$ (10,179)				
57										
58	KAWC Revenue Conversion Factor									
59										
60	AG Revenue Conversion Factor	1.65249	-1.65249	-1.65249	-1.65249	1.65249	-1.65249			
61										
62	Incremental Revenue Requirement	$ (2,905,537)	$ 187,687	$ (29,830)	$ (3,419)	$ (16,820)	$ 2,922			

Note: Difference from Schedule 1 due to rounding.

Response of Michael J. Majoros, Jr.

2. Refer to Direct Testimony of Michael J. Majoros, Jr., Exhibit MJM-1, Schedule 2.

   a. Explain why the tax effects of the AG's proposed expense adjustments shown in the working capital calculation were not also included in the working capital calculation.

   b. Explain the lack of any adjustment for the change in AFUDC in the working capital calculation.

Response: a. and b. Mr. Majoros is providing a revised proposal to incorporate this adjustment. Please see Exhibit___(MJM-3) Updated, Schedule 3, attached to these responses, for the calculation of an updated cash working capital. The tax effects of AG Adjustment Nos. 3 through 9 and 11 through 13 have been included in the working capital calculation. The tax effects of the two Interest Synchronization adjustments (Adjustment Nos. 10 and 15) have not been included. Mr. Majoros was not able to include these adjustments without incurring a circular formula in his files. However, due to the rounding of the cash working capital, the exclusion of the adjustments has minimal impact.

The change in cash working capital from Mr. Majoros's original calculation is shown on Exhibit___(MJM-3) Updated, Schedule 1, and carried forward to Exhibit___(MJM-1) Updated, Schedule 2, as AG Adjustment No. 14. The additional Interest Synchronization brought about by the cash working capital change is shown on Exhibit___(MJM-4), Schedule 12, and is carried forward to Exhibit___(MJM-1) Updated, Schedule 2, as AG Adjustment No. 15.

KENTUCKY AMERICAN WATER COMPANY
FUTURE TEST YEAR ENDING NOVEMBER 30, 2008
RATE BASE SUMMARY

Line No.	Rate Base Component	Company Claim 1/ (a)	Original AG Recommended Position (b)	Original Adjustment (c)=(b)-(a)	Updated AG Recommended Position (d)	AG Additional Adjustment (e)=(d)-(b)
1						
2	Utility Plant In Service	$ 366,185,081	$ 366,185,081	$ -	366,185,081	$ -
3						
4	Property Held for Future Use	-	-	-		
5						
6	Utility Plant Acquisition Adjustments	38,065	38,065	-	38,065	-
7						
8	Accumulated Depreciation	(94,623,187)	(94,209,638) 2/	413,549	(94,209,638)	-
9						
10	Accumulated Amortization	-				
11						
12	Net Utility Plant In Service	$ 271,599,959	$ 272,013,508	$ 413,549	$ 272,013,508	$ -
13						
14						
15	Construction Work in Progress	23,186,818	23,186,818	-	23,186,818	-
16						
17	Working Capital Allowance	3,596,000	3,327,000 3/	(269,000)	3,196,000 4/	(131,000)
18						
19	Other Working Capital Allowance	523,761	523,761	-	523,761	-
20						
21	Contributions in Aid of Construction	(46,562,799)	(46,562,799)	-	(46,562,799)	-
22						
23	Customer Advances	(21,380,918)	(21,380,918)	-	(21,380,918)	-
24						
25	Deferred Income Taxes	(30,854,190)	(30,854,190)	-	(30,854,190)	-
26						
27	Deferred Investment Tax Credits	(94,805)	(94,805)	-	(94,805)	-
28						
29	Deferred Maintenance	1,741,451	1,741,451	-	1,741,451	-
30						
31	Deferred Debits	1,897,923	1,897,923	-	1,897,923	-
32						
33	Other Rate Base Elements	(1,552,510)	(1,552,510)	-	(1,552,510)	-
34						
45	Jurisdictional Rate Base	$ 202,100,690	$ 202,245,239	$ 144,549	$ 202,114,239	$ (131,000)

Sources:
1/ KAWC Schedule B-1, p. 2 of 2.
2/ Accumulated depreciation as calculated by "KAW_R_AGDR2#6_RB07_071607.xls" when AG recommended depreciation rates are used. See Schedule 2.
3/ See Exhibit___(MJM_3), Schedule 3.
4/ See Exhibit___(MJM_3) Updated, Schedule 3.

KENTUCKY-AMERICAN WATER COMPANY

SUMMARY OF ATTORNEY GENERAL ADJUSTMENTS

Line No.	Major Group Classification	Company Forecasted Revenues & Expenses	AG Adj. 1 Depreciation Impact on Ratebase	AG Adj. 2 Cash Working Capital	AG Adj. 3 Consolidated Taxes	AG Adj. 4 Excess Management Fees	AG Adj. 5 Depreciation Expense	AG Adj. 6 Incentive Pay	AG Adj. 7 Group Insurance	AG Adj. 8 Bus. Devel. Portion of Mgmt. Fees	AG Adj. 9 Wastewater Technician	AG Adj. 10 Interest Synchronization	Total AG Original Adjustments
1													
2	**Operating Revenues**												
3	Water Sales	$ 49,242,905	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
4	Other Operating Revenues	3,760,392	-	-	-	-	-	-	-	-	-	-	-
5		$ 53,003,297	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
6	**Operating Expenses**												
7	Labor	$ 6,248,477	$ -	$ -	$ -	$ -	$ -	$ (252,550)	$ -	$ -	$ (12,497)	$ -	$ (265,047)
8	Purchased Water	477,463	-	-	-	-	-	-	-	-	-	-	-
9	Fuel and Power	2,986,277	-	-	-	-	-	-	-	-	-	-	-
10	Chemicals	1,505,218	-	-	-	-	-	-	-	-	-	-	-
11	Waste Disposal	262,237	-	-	-	-	-	-	-	-	-	-	-
12	Management Fees	6,201,194	-	-	-	(922,871)	-	-	-	(79,365)	-	-	(1,002,236)
13	Group Insurance	1,876,895	-	-	-	-	-	-	(114,696)	-	-	-	(114,696)
14	Pensions	502,684	-	-	-	-	-	-	-	-	-	-	-
15	Regulatory Expense	292,195	-	-	-	-	-	-	-	-	-	-	-
16	Insurance Other than Group	663,910	-	-	-	-	-	-	-	-	-	-	-
17	Customer Accounting	1,376,372	-	-	-	-	-	-	-	-	-	-	-
18	Rents	52,165	-	-	-	-	-	-	-	-	-	-	-
19	General Office Expense	475,196	-	-	-	-	-	-	-	-	-	-	-
20	Miscellaneous	3,002,289	-	-	-	-	-	-	-	-	-	-	-
21	Maintenance - Other	1,507,210	-	-	-	-	-	-	-	-	-	-	-
22													
23	Total O & M Expenses	$ 27,429,783	$ -	$ -	$ -	$ (922,871)	$ -	$ (252,550)	$ (114,696)	$ (79,365)	$ (12,497)	$ -	$ (1,381,979)
24													
25	Depreciation	$ 8,038,653	$ -	$ -	$ -	$ -	$ (416,463)	$ -	$ -	$ -	$ -	$ -	$ (416,463)
26	Amortization	450,971	-	-	-	-	-	-	-	-	-	-	-
27													
33	Total General Taxes	3,297,769	-	-	-	-	-	-	-	-	-	-	-
34													
42	Total Income Taxes	2,980,507	-	-	(894,416)	358,997	162,004	98,242	44,617	30,873	4,861	13,772	(181,050)
43													
44													
45	Total Operating Expenses	$ 42,197,683	$ -	$ -	$ (894,416)	$ (563,874)	$ (254,459)	$ (154,308)	$ (70,079)	$ (48,492)	$ (7,636)	$ 13,772	$ (1,979,492)
46													
47	Utility Operating Income	$ 10,805,614	$ -	$ -	$ 894,416	$ 563,874	$ 254,459	$ 154,308	$ 70,079	$ 48,492	$ 7,636	$ (13,772)	$ 1,979,492
48													
49													
50	Rate Base	$202,100,690	$ 413,549	$ (269,000)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 144,549
51													
52	KAWC Proposed ROR	8.64%											
53													
54	AG Recommended ROR	7.77%	7.77%	7.77%									
55													
56	NOI Effect	$ (1,758,276)	$ 32,133	$ (20,901)									
57													
58	KAWC Revenue Conversion Factor												
59													
60	AG Revenue Conversion Factor	1.65249	1.65249	1.65249	-1.65249	-1.65249	-1.65249	-1.65249	-1.65249	-1.65249	-1.65249	-1.65249	
61													
62	Incremental Revenue Requirement	$ (2,905,537)	$ 53,099	$ (34,539)	$ (1,478,016)	$ (931,798)	$ (420,492)	$ (254,993)	$ (115,805)	$ (80,133)	$ (12,618)	$ 22,759	$ (6,158,073)

Note: Difference from Schedule 1 due to rounding.

KENTUCKY-AMERICAN WATER COMPANY

SUMMARY OF ATTORNEY GENERAL ADJUSTMENTS

			Additional Adjustments For Update							
Line No.	Major Group Classification	Company Forecasted Revenues & Expenses	AG Adj. 11 AFUDC	AG Adj. 12 Uncollectibles Expense	AG Adj. 13 Memberships	AG Adj. 14 Additional Cash Working Capital	AG Adj. 15 Additional Interest Synchronization	Total AG Additional Adjustments	Total AG Adjustments	AG Updated Recommended Revenues and Expenses
1										
2	**Operating Revenues**									
3	Water Sales	$ 49,242,905	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 49,242,905
4	Other Operating Revenues	3,760,392	(185,889)	-	-	-	-	(185,889)	(185,889)	3,574,503
5		$ 53,003,297	$ (185,889)	$ -	$ -	$ -	$ -	$ (185,889)		$ 52,817,408
6	**Operating Expenses**									
7	Labor	$ 6,248,477	$ -	$ -	$ -	$ -	$ -	$ -	$ (265,047)	$ 5,983,430
8	Purchased Water	477,463	-	-	-	-	-	-	-	477,463
9	Fuel and Power	2,986,277	-	-	-	-	-	-	-	2,986,277
10	Chemicals	1,505,218	-	-	-	-	-	-	-	1,505,218
11	Waste Disposal	262,237	-	-	-	-	-	-	-	262,237
12	Management Fees	6,201,194	-	-	-	-	-	-	(1,002,236)	5,198,958
13	Group Insurance	1,876,895	-	-	-	-	-	-	(114,696)	1,762,199
14	Pensions	502,684	-	-	-	-	-	-	-	502,684
15	Regulatory Expense	292,195	-	-	-	-	-	-	-	292,195
16	Insurance Other than Group	663,910	-	-	-	-	-	-	-	663,910
17	Customer Accounting	1,376,372	-	(29,544)	-	-	-	(29,544)	(29,544)	1,346,828
18	Rents	52,165	-	-	-	-	-	-	-	52,165
19	General Office Expense	475,196	-	-	-	-	-	-	-	475,196
20	Miscellaneous	3,002,289	-	-	(3,386)	-	-	(3,386)	(3,386)	2,998,903
21	Maintenance - Other	1,507,210	-	-	-	-	-	-	-	1,507,210
22									-	
23	Total O & M Expenses	$ 27,429,783	$ -	$ (29,544)	$ (3,386)	$ -	$ -	$ (32,930)		$ 26,014,874
24										
25	Depreciation	$ 8,038,653	$ -	$ -	$ -	$ -	$ -	$ -	$ (416,463)	$ 7,622,190
26	Amortization	450,971	-	-	-	-	-	-	-	450,971
27										
33	Total General Taxes	3,297,769	-	-	-	-	-	-	-	3,297,769
34										
42	Total Income Taxes	2,980,507	(72,311)	11,493	1,317	-	1,768	(57,733)	(238,783)	2,741,724
43										
44										
45	Total Operating Expenses	$ 42,197,683	$ (72,311)	$ (18,051)	$ (2,069)	$ -	$ 1,768	$ (90,663)	$ (655,246)	$ 40,127,528
46										
47	Utility Operating Income	$ 10,805,614	$ (113,578)	$ 18,051	$ 2,069	$ -	$ (1,768)	$ (95,226)	$ 655,246	$ 12,689,880
48										
49										
50	Rate Base	$202,100,690	$ -	$ -	$ -	$ (131,000)	$ -	$ (131,000)	$ 13,549	$ 202,114,239
51										
52	KAWC Proposed ROR	8.64%								
53										
54	AG Recommended ROR	7.77%				7.77%				
55										
56	NOI Effect	$ (1,758,276)				$ (10,179)				
57										
58	KAWC Revenue Conversion Factor									
59										
60	AG Revenue Conversion Factor	1.65249	-1.65249	-1.65249	-1.65249	1.65249	-1.65249			
61										
62	Incremental Revenue Requirement	$ (2,905,537)	$ 187,687	$ (29,830)	$ (3,419)	$ (16,820)	$ 2,922			

Note: Difference from Schedule 1 due to rounding.

KENTUCKY AMERICAN WATER COMPANY
FUTURE TEST YEAR ENDING NOVEMBER 30, 2008

AG Adjustment No. 15 (Update)

Additional Interest Synchronization

Line	Description		Amount	
1	Updated Pro Forma Rate Base	$	202,114,239	1/
2	Weighted Cost of Debt		3.47%	2/
3	Pro Forma Interest Expense		7,013,364	
4	Company Claim	$	7,053,314	3/
5	Increase in Taxable Income		39,950	
6	Tax Rate		38.90%	
7	Income Taxes	$	15,541	
8	AG Original Interest Synchronization Adj.		13,772	4/
9	Additional Interest Synchronization Adj. (L. 7 - L. 8)		1,768	

Sources:
1/ See Exhibit___(MJM-3) Updated, Schedule 1.
2/ See Exhibit___(MJM-2).
3/ KAWC Schedule E-1.3, page 1 of 2.
4/ See Exhibit___(MJM-4), Schedule 8.

Response of Michael J. Majoros, Jr.

3. Mr. Majoros recommends that forecasted service company charges be decreased by $922,871 for excess fees and $79,365 for business development costs. State whether Mr. Majoros' calculation of working capital takes into account these adjustments. If it does not, explain why it does not.

Response:

Mr. Majoros is providing a revised proposal to incorporate this adjustment. Please see Exhibit___(MJM-3) Updated, Schedule 3, attached to these responses.

KENTUCKY-AMERICAN WATER COMPANY
FUTURE TEST YEAR ENDING NOVEMBER 30, 2008

AG ADJUSTMENT NO. 2
AG ADJUSTMENT TO CASH WORKING CAPITAL
WORKING CAPITAL - LEAD/LAG STUDY

			Company Proposed 1/		AG Recommended
Lines	Description		Total Water		Total Water
1	Total Operating Funds		64,354,398		62,268,703
2					
3	Average Daily Operating Funds		176,313		170,599
4					
5	Composite Average Days Interval Between:				
6					
7	(A) Date Service Furnished and Date Collections Deposited	Days	43.18		43.18
8					
9	(B) Date Expenses Incurred and Date of Payment	Days	22.81	2/	24.44
10					
11	(C) Net Interval		20.37		18.74
12					
13	Total Working Capital		$3,590,875		$3,196,425
14					
15	Use		$3,596,000	3/	$3,196,000
16					
17	Difference				(400,000)
18					

KENTUCKY-AMERICAN WATER COMPANY
FUTURE TEST YEAR ENDING NOVEMBER 30, 2008

AG ADJUSTMENT NO. 2
AG ADJUSTMENT TO CASH WORKING CAPITAL
WORKING CAPITAL - LEAD/LAG STUDY

Lines	Description	Company Proposed 1/ Total Water Amount Total	Company Proposed Post Payment or (Lead) Days	Company Proposed Dollar Days Total	AG Adjustment		AG Recommended Total Water Amount Total	AG Recommended Post Payment or (Lead) Days	AG Recommended Dollar Days Total
19									
20									
21	DESCRIPTION								
22	Payrolls Charged to Expense - Union/ATS Group	4,260,316	12.00	51,123,792	(12,497)	4/	4,247,819	12	50,973,828
23	Payrolls Charged to Expense - Salaried	1,988,161	12.00	23,857,932	(252,550)	5/	1,735,611	12	20,827,332
24	Total Payroll	6,248,477		74,981,724	(265,047)		5,983,430		71,801,160
25									
26	Fuel and Power	2,986,277	26.96	80,510,027			2,986,277	27	80,510,027
27	Chemicals	1,505,218	6.65	10,009,700			1,505,218	7	10,009,700
28	Service Company Charges	6,201,194	0.40	2,480,478	(1,002,236)	6/	5,198,958	0	2,079,583
29	Group Insurance	1,426,861	(6.81)	(9,716,923)	(114,696)	7/	1,312,165	(7)	(8,935,844)
30	Opeb	450,034	23.13	10,409,286			450,034	23	10,409,286
31	Insurance Other than Group	663,910	(44.70)	(29,676,777)			663,910	(45)	(29,676,777)
32	Transportation Expense	567,498	13.56	7,695,273			567,498	14	7,695,273
33	Rents	52,165	18.39	959,314			52,165	18	959,314
34	Telephone Expense	186,090	10.31	1,918,588			186,090	10	1,918,588
35	Postage Expense	480,000	23.47	11,265,600			480,000	23	11,265,600
36	Stock E	90,807	28.03	2,545,320			90,807	28	2,545,320
37	Maintenance Expense, excluding Amortizations	1,122,962	18.54	20,819,715			1,122,962	19	20,819,715
38	Amortization	293,441	-	-			293,441	-	-
39	Uncollectibles	418,563	-	-	(29,544)	8/	389,019	-	-
40	Waste Disposal	262,237	-	-			262,237	-	-
41	Other Operating Expenses	4,474,048	24.44	109,345,729	(3,386)	9/	4,470,662	24	109,262,976
42	Total O & M Expenses	27,429,783		293,547,054	(1,414,909)		26,014,874		290,663,921
43									
44	Depreciation and Amortization	8,502,675	-	-	(416,463)	10/	8,086,211	-	-
45	Taxes, Other than Income								
46	Payroll - FUTA	6,096	69.86	425,867			6,096	70	425,867
47	Payroll - SUTA	5,331	75.14	400,571			5,331	75	400,571
48	Payroll - FICA	471,360	15.00	7,070,400			471,360	15	7,070,400
49	Other	2,814,982	70.95	199,722,973			2,814,982	71	199,722,973
50	Income Taxes - Current - SIT	958,767	52.75	50,574,959			958,767	53	50,574,959
51	Income Taxes - Current - FIT	5,257,239	30.13	158,400,611	(254,323)	11/	5,002,916	30	150,737,853
52	Deferred Income Taxes	1,002,045	-	-			1,002,045	-	-
53	Interest Expense - Long - Term Debt	6,649,112	119.64	795,499,760			6,649,112	120	795,499,760
54	Interest Expense - Short - Term Debt	404,202	14.60	5,901,349			404,202	15	5,901,349
55	Preferred Dividends	444,622	46.40	20,630,461			444,622	46	20,630,461
56	Net Income	10,408,185	-	-			10,408,185	-	-
57									
58	Net Operating Funds	64,354,398		1,532,174,005	(2,085,695)		62,268,703		1,521,628,114
59									
60	Average Days Interval between Date Expenses are Incurred and Date of Payment			22.81 2/					24.44

KENTUCKY-AMERICAN WATER COMPANY
FUTURE TEST YEAR ENDING NOVEMBER 30, 2008

AG ADJUSTMENT NO. 2
AG ADJUSTMENT TO CASH WORKING CAPITAL
WORKING CAPITAL - LEAD/LAG STUDY

Lines	Description	Company Proposed 1/			AG Recommended		
		Total Water			Total Water		
61							
62		Revenues	Median	Dollar Days	Revenues	Median	Dollar Days
63		Total	Service Days	Total	Total	Service Days	Total
64							
65							
66	Monthly - Arrears Full Bills	45,915,718	15.21	698,378,071	45,915,718	15.21	698,378,071
67							
68	Other Revenues	3,950,872	34.54	136,463,119	3,950,872	34.54	136,463,119
69							
70	Fire Service	3,327,187	(15.26)	(50,772,874)	3,327,187	(15.26)	(50,772,874)
71							
72	Total	53,193,777		784,068,316	53,193,777		784,068,316
73							
74							
75	Average Median Service Days	14.74			14.74		
76							
77	Number of Days between the Reading Date and the						
78	Billing Date	4.17			4.17		
79							
80	Number of Days between the Billing Date and the						
81	Date the Bills are Paid	24.27			24.27		
82							
83	Total Average Days' Interval between Number of Days						
84	from Date Services are Furnished to Date Collections						
85	are Received	43.18			43.18		

1/ KAWC Schedule B-5.2, pp. 4-6, summed for total company.
2/ Company used this for each division. It is the Lexington number.
3/ Difference due to composite calculation.
4/ See Exhibit___(MJM-4), Schedule 7.
5/ See Exhibit___(MJM-4), Schedule 4.
6/ See Exhibit___(MJM04) Updated, Schedules 2 and 6.
7/ See Exhibit___(MJM-4), Schedule 5.
8/ See Exhibit___(MJM-4) Updated, Schedule 10.
9/ See Exhibit___(MJM-4) Updated, Schedule 11.
10/ See Exhibit___(MJM-4), Schedule 3.
11/ See Exhibit___(MJM-1) Updated, Schedule 2. Amount does not include Interest Synchronization (Adjs. 10 and 15).

Response of Michael J. Majoros, Jr.

4. Mr. Majoros recommends the elimination of $922,871 of Kentucky-American's requested $6,201,194 forecasted management fees.

   a. Describe the weight that Mr. Majoros gave to the Direct Testimony of Patrick Baryenbruch and Mr. Baryenbruch's study in developing his recommendation.

   b. Describe how Mr. Majoros used Mr. Baryenbuch's testimony and study in developing his recommendation.

   c. Describe how Mr. Majoros used Kentucky-American's responses to interrogatories regarding Mr. Baryenbruch's testimony and study in developing his recommendation.

   d. State Mr. Majoros' conclusions regarding the findings of Mr. Baryenbruch's study and the basis for these conclusions.

Response:

a. Mr. Majoros gave no weight to Mr. Baryenbruch's study in developing his numbers. Mr. Miller's numbers were Kentucky specific.

b. See above.

c. N/A

d. Mr. Baryenbruch conducted a study on behalf of a utility supportive of its management fees. At this time, Mr. Majoros has no other conclusions.

Response of Michael J. Majoros, Jr.

5. At page 11 of his direct testimony, Mr. Majoros states that "Mr. Spanos' negative 120 percent future net salvage will increase the regulatory liability because the annual accruals will vastly exceed KAWC's annual cost of removal experience." This statement appears to conflict with Kentucky-American's historic removal costs in which cost of removal generally exceeds the cost of the removed assets by more than 120 percent. See Direct Testimony of John J. Spanos, Exhibit JJS-1 at III-88. State whether, in light of this conflict, Mr. Majoros wishes to revise his statement. Explain.

Response:

Mr. Majoros does not wish to revise his statement, because it is correct. If you calculate Mr. Spanos's annual accrual on for Services as shown on page III-4, but without the negative 120 cost of removal ratio, you will get an accrual of $427,540. This is $744,208 less that the $1,171,749 accrual Mr. Spanos is proposing as shown on the same page. That means Mr. Spanos is proposing to collect at least $744,540 each year for cost of removal. However, if you look at page III-89 of Mr. Spanos study, you will see that KAWC is only spending $107,180 for cost of removal. The regulatory liability will grow each year based on the $637,029 annual over-collection.

Response of Michael J. Majoros, Jr.

6. Refer to Direct Testimony of Michael J. Majoros, Jr., Exhibit MJM-4, Schedule 3 at 4.

   a. State whether Mr. Majoros expects Kentucky-American to replace the entire $35 million reported as Services as of December 31, 2006.

   b. Explain why it is appropriate to limit Kentucky-American's recovery to $6,098,542 over the 56.9 year remaining life, or $107,180 annually, when the historic information supplied in Mr. Spanos' testimony suggests that the historic net salvage is 229 percent of the cost of the services. See Direct Testimony of John J. Spanos, Exhibit JJS-1 at III-88 and III-89.

   c. Provide all publications, treatises, studies, and authoritative reports that regard or recognize Mr. Majoros' methodology as generally acceptable.

   d. Identify the state and federal regulatory commissions that have accepted Mr. Majoros' salvage ratios methodology. Provide a copy of each state or federal regulatory commission decision in which the methodology is considered and accepted.

   e. Identify the state and federal regulatory commissions that have declined to apply Mr. Majoros' salvage ratios methodology. Provide a copy of each state or federal regulatory commission decision in which the methodology is considered and not applied or accepted.

Response:

a. Probably not all. Some will be abandoned in place.

Response of Michael J. Majoros, Jr.

b. Mr. Majoros does not propose to limit KAWC's recovery. He merely seeks to base it on a reasonable amount, given the company's actual experience, and to place the future net salvage estimate on its present value. He expects the ratio will increase overtime in line with actual future inflation.

c. In Mr. Majoros's opinion, his approach is consistent with Mr. Spanos' recommendations. Based on a comparison of Mr. Spanos' recommendations with his own results, Mr. Spanos is proposing future net salvage ratios based on his judgmental estimates of their present values. In Mr. Majoros's opinion, Mr. Spanos did not support his judgment for Services. Hence, Mr. Majoros has made an alternative recommendation, and he has explained how he arrived at his recommendation. Mr. Majoros does not see where Mr. Spanos has explained his individual cost of removal recommendations, even though he has accepted all but one of them.

d. If you are asking about Mr. Majoros's judgmental acceptance of Mr. Spanos's proposals, the KPSC accepted or at least considered positively Mr. Majoros's similar recommendations in UHL&P Case 2005-00042.

e. Mr. Majoros is not advocating any particular methodology in this proceeding, other than as explained in response to Question 6.b. above.

Response of Michael J. Majoros, Jr.

7. Provide all publications, treatises, studies, state or federal regulatory commission decisions, and authoritative reports that regard or recognize the inclusion of the accumulated deprecation resulting from the non-legal asset retirement obligations ("AROs") in the development of remaining life depreciation rates as generally acceptable.

Response:

SFAS No. 143 precludes such treatment for non-utilities. Mr. Majoros believes FERC Order No. 631 would recognize such treatment. The KPSC has allowed such treatment.

Response of Michael J. Majoros, Jr.

8. Explain why Mr. Majoros did not adjust forecasted uncollectibles expense to .79 percent of water sales as was used in the determination of the AG's revenue conversion factor.

Response:

Mr. Majoros is providing a revised proposal to incorporate this adjustment. Please see Exhibit___(MJM-4) Updated, Schedule 10 for Adjustment 12, which is the AG's new uncollectibles expense adjustment. Adjustment 12 is carried forward to Exhibit___(MJM-1) Updated, Schedule 2. Both exhibits are attached to these responses.

KENTUCKY AMERICAN WATER COMPANY
FUTURE TEST YEAR ENDING NOVEMBER 30, 2008

AG Adjustment No. 12 (Update)

Adjust Uncollectibles Expense for AG Uncollectible Rate

Line	Description		Amount	
1	Company Uncollectibles Expense	$	418,563	1/
2	AG Uncollectibles Expense		389,019	2/
3	Difference (L. 1 - L. 2)		29,544	
4	Adjustment - Pre Tax	$	(29,544)	
5	Tax Rate		38.90%	
6	Tax Effect (L. 4 * L. 5)	$	11,493	
7	Adjustment - Post Tax (L. 4 + L. 6)	$	(18,051)	
8	Revenue Conversion Factor		1.65249	
9	Revenue Requirement (L. 7 * L. 8)	$	(29,830)	

Sources:

1/ KAW_R_AGDR1#46_custacct_061807.xls, Uncollectibles tab.
2/ KAW_R_AGDR1#46_const_061807.xls, Uncollectibles tab, using AG uncollectibles rate of 0.79%.

Kentucky-American Water Company
Forecasted Uncollectibles Expense
CASE NO: 2007-00143

Hitorical Information

	Billed Revenues Lexington	Elk Lake	Tri Village	Owenton	Total	Net charge-offs		
2004	39,772,371		830,893	-	40,603,264	376,473.37	0.93%	
2005	47,061,606		919,435	1,760	47,982,801	398,108.09	0.83%	
2006	46,986,741	-	970,979	711,093	48,668,813	384,317.63	0.79%	
							2.55%	0.85%

Historical Information Lexington

2004	39,772,371
2005	47,061,606
2006	46,986,741

Historical Information Tri Village

2004	830,893
2005	919,435
2006	970,979

Historical Information Elk Lake

2001	
2002	
2003	

Historical information Owenton

2004	
2005	1,760
2006	711,093

Forecasted Information Dec 07 Nov 08 at present rates

Lexington	47,387,575	402,793	
Tri Village	1,156,141	9,827	
Elk Lake	93,638	796	
Owenton	605,551	5,147	
	49,242,905	418,563	
Uncollectibles	418,565		
	0.850000%	Three year average	

Uncollectibles Expense using AG Uncollectibles Rate

Lexington	47,387,575	374,361	
Tri Village	1,156,141	9,134	
Elk Lake	93,638	740	
Owenton	605,551	4,784	
	49,242,905	389,019	
Uncollectibles	389,019		
	0.790000%	AG Recommended Rate	

Source: KAW_R_AGDR1#46_const_061807.xls, Uncollectibles tab.

KENTUCKY-AMERICAN WATER COMPANY

SUMMARY OF ATTORNEY GENERAL ADJUSTMENTS

Line No.	Major Group Classification	Company Forecasted Revenues & Expenses	AG Adj. 1 Depreciation Impact on Ratebase	AG Adj. 2 Cash Working Capital	AG Adj. 3 Consolidated Taxes	AG Adj. 4 Excess Management Fees	AG Adj. 5 Depreciation Expense	AG Adj. 6 Incentive Pay	AG Adj. 7 Group Insurance	AG Adj. 8 Bus. Devel. Portion of Mgmt. Fees	AG Adj. 9 Wastewater Technician	AG Adj. 10 Interest Synchronization	Total AG Original Adjustments
1													
2	**Operating Revenues**												
3	Water Sales	$ 49,242,905	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
4	Other Operating Revenues	3,760,392	-	-	-	-	-	-	-	-	-	-	-
5		$ 53,003,297	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
6	**Operating Expenses**												
7	Labor	$ 6,248,477	$ -	$ -	$ -	$ -	$ -	$ (252,550)	$ -	$ -	$ (12,497)	$ -	$ (265,047)
8	Purchased Water	477,463	-	-	-	-	-	-	-	-	-	-	-
9	Fuel and Power	2,986,277	-	-	-	-	-	-	-	-	-	-	-
10	Chemicals	1,505,218	-	-	-	-	-	-	-	-	-	-	-
11	Waste Disposal	262,237	-	-	-	-	-	-	-	-	-	-	-
12	Management Fees	6,201,194	-	-	-	(922,871)	-	-	-	(79,365)	-	-	(1,002,236)
13	Group Insurance	1,876,895	-	-	-	-	-	-	(114,696)	-	-	-	(114,696)
14	Pensions	502,684	-	-	-	-	-	-	-	-	-	-	-
15	Regulatory Expense	292,195	-	-	-	-	-	-	-	-	-	-	-
16	Insurance Other than Group	663,910	-	-	-	-	-	-	-	-	-	-	-
17	Customer Accounting	1,376,372	-	-	-	-	-	-	-	-	-	-	-
18	Rents	52,165	-	-	-	-	-	-	-	-	-	-	-
19	General Office Expense	475,196	-	-	-	-	-	-	-	-	-	-	-
20	Miscellaneous	3,002,289	-	-	-	-	-	-	-	-	-	-	-
21	Maintenance - Other	1,507,210	-	-	-	-	-	-	-	-	-	-	-
22													
23	Total O & M Expenses	$ 27,429,783	$ -	$ -	$ -	$ (922,871)	$ -	$ (252,550)	$ (114,696)	$ (79,365)	$ (12,497)	$ -	$ (1,381,979)
24													
25	Depreciation	$ 8,038,653	$ -	$ -	$ -	$ -	$ (416,463)	$ -	$ -	$ -	$ -	$ -	$ (416,463)
26	Amortization	450,971	-	-	-	-	-	-	-	-	-	-	-
27													
33	Total General Taxes	3,297,769	-	-	-	-	-	-	-	-	-	-	-
34													
42	Total Income Taxes	2,980,507	-	-	(894,416)	358,997	162,004	98,242	44,617	30,873	4,861	13,772	(181,050)
43													
44													
45	Total Operating Expenses	$ 42,197,683	$ -	$ -	$ (894,416)	$ (563,874)	$ (254,459)	$ (154,308)	$ (70,079)	$ (48,492)	$ (7,636)	$ 13,772	$ (1,979,492)
46													
47	Utility Operating Income	$ 10,805,614	$ -	$ -	$ 894,416	$ 563,874	$ 254,459	$ 154,308	$ 70,079	$ 48,492	$ 7,636	$ (13,772)	$ 1,979,492
48													
49													
50	Rate Base	$202,100,690	$ 413,549	$ (269,000)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 144,549
51													
52	KAWC Proposed ROR	8.64%											
53													
54	AG Recommended ROR	7.77%	7.77%	7.77%									
55													
56	NOI Effect	$ (1,758,276)	$ 32,133	$ (20,901)									
57													
58	KAWC Revenue Conversion Factor												
59													
60	AG Revenue Conversion Factor	1.65249	1.65249	1.65249	-1.65249	-1.65249	-1.65249	-1.65249	-1.65249	-1.65249	-1.65249	-1.65249	
61													
62	Incremental Revenue Requirement	$ (2,905,537)	$ 53,099	$ (34,539)	$ (1,478,016)	$ (931,798)	$ (420,492)	$ (254,993)	$ (115,805)	$ (80,133)	$ (12,618)	$ 22,759	$ (6,158,073)

Note: Difference from Schedule 1 due to rounding.

KENTUCKY-AMERICAN WATER COMPANY

SUMMARY OF ATTORNEY GENERAL ADJUSTMENTS

Line No.	Major Group Classification	Company Forecasted Revenues & Expenses	Additional Adjustments For Update: AG Adj. 11 AFUDC	AG Adj. 12 Uncollectibles Expense	AG Adj. 13 Memberships	AG Adj. 14 Additional Cash Working Capital	AG Adj. 15 Additional Interest Synchronization	Total AG Additional Adjustments	Total AG Adjustments	AG Updated Recommended Revenues and Expenses
1										
2	**Operating Revenues**									
3	Water Sales	$ 49,242,905	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 49,242,905
4	Other Operating Revenues	3,760,392	(185,889)	-	-	-	-	(185,889)	(185,889)	3,574,503
5		$ 53,003,297	$ (185,889)	$ -	$ -	$ -	$ -	$ (185,889)		$ 52,817,408
6	**Operating Expenses**									
7	Labor	$ 6,248,477	$ -	$ -	$ -	$ -	$ -	$ -	$ (265,047)	$ 5,983,430
8	Purchased Water	477,463	-	-	-	-	-	-	-	477,463
9	Fuel and Power	2,986,277	-	-	-	-	-	-	-	2,986,277
10	Chemicals	1,505,218	-	-	-	-	-	-	-	1,505,218
11	Waste Disposal	262,237	-	-	-	-	-	-	-	262,237
12	Management Fees	6,201,194	-	-	-	-	-	-	(1,002,236)	5,198,958
13	Group Insurance	1,876,895	-	-	-	-	-	-	(114,696)	1,762,199
14	Pensions	502,684	-	-	-	-	-	-	-	502,684
15	Regulatory Expense	292,195	-	-	-	-	-	-	-	292,195
16	Insurance Other than Group	663,910	-	-	-	-	-	-	-	663,910
17	Customer Accounting	1,376,372	-	(29,544)	-	-	-	(29,544)	(29,544)	1,346,828
18	Rents	52,165	-	-	-	-	-	-	-	52,165
19	General Office Expense	475,196	-	-	-	-	-	-	-	475,196
20	Miscellaneous	3,002,289	-	-	(3,386)	-	-	(3,386)	(3,386)	2,998,903
21	Maintenance - Other	1,507,210	-	-	-	-	-	-	-	1,507,210
22									-	
23	Total O & M Expenses	$ 27,429,783	$ -	$ (29,544)	$ (3,386)	$ -	$ -	$ (32,930)		$ 26,014,874
24										
25	Depreciation	$ 8,038,653	$ -	$ -	$ -	$ -	$ -	$ -	$ (416,463)	$ 7,622,190
26	Amortization	450,971	-	-	-	-	-	-	-	450,971
27										
33	Total General Taxes	3,297,769	-	-	-	-	-	-	-	3,297,769
34										
42	Total Income Taxes	2,980,507	(72,311)	11,493	1,317	-	1,768	(57,733)	(238,783)	2,741,724
43										
44										
45	Total Operating Expenses	$ 42,197,683	$ (72,311)	$ (18,051)	$ (2,069)	$ -	$ 1,768	$ (90,663)	$ (655,246)	$ 40,127,528
46										
47	Utility Operating Income	$ 10,805,614	$ (113,578)	$ 18,051	$ 2,069	$ -	$ (1,768)	$ (95,226)	$ 655,246	$ 12,689,880
48										
49										
50	Rate Base	$202,100,690	$ -	$ -	$ -	$ (131,000)	$ -	$ (131,000)	$ 13,549	$202,114,239
51										
52	KAWC Proposed ROR	8.64%								
53										
54	AG Recommended ROR	7.77%				7.77%				
55										
56	NOI Effect	$ (1,758,276)				$ (10,179)				
57										
58	KAWC Revenue Conversion Factor									
59										
60	AG Revenue Conversion Factor	1.65249	-1.65249	-1.65249	-1.65249	1.65249	-1.65249			
61										
62	Incremental Revenue Requirement	$ (2,905,537)	$ 187,687	$ (29,830)	$ (3,419)	$ (16,820)	$ 2,922			

Note: Difference from Schedule 1 due to rounding.

Response of Michael J. Majoros, Jr.

9. Refer to Kentucky-American's Response to Commission Staff's Third Set of Information Requests, Item 42(a) and (b). State whether the AG agrees with Kentucky-American's position. Explain.

Response:

It is appropriate to look at as much information as possible and see if the model is providing correct results; AG is not opposed to these responses. AG, however is always interested in legitimate improvements to such models. AG does not object to KAWC's position.

Response of Michael J. Majoros, Jr.

10. Refer to Direct Testimony of Michael J. Majoros, Jr. at 14, lines 3 – 10.

    a. State, in light of KRS 278.192 which permits a forward looking test period, why Mr. Majoros considers the medical trend rates provided by Towers and Perrin insufficient to adjust medical insurance premiums.

    b. Describe the evidence that Mr. Majoros would find adequate and reasonable to support the forecasting of medical insurance premiums.

Response:

a. Mr. Majoros was attempting to replicate the Commission's approach used in Case No. 2004-00103 for OPEBs (see Order issued February 28, 2005, pages 55 to 56). Regardless of who Towers Perrin is, it is reasonable to have a basis for such a large increase rather than just a number.

b. Rationale for the 8% rather than just a number.

Response of Michael J. Majoros, Jr.

11. Refer to Kentucky-American's Application, Exhibit 37, Schedule F. Kentucky-American has included in forecasted expenses $3,386 to the Rotary Club, Audubon Society, Lexington Forum, and Bluegrass Trust. State the AG's position on the recovery of these expenses through general rates.

Response:

The Attorney General asserts that expenses, even those having a minimal effect on operating income, must be borne by the shareholders unless such expenses are proven beneficial to ratepayers in furnishing utility service. See, *In the Matter of: Notice of Adjustment of Rate of Kentucky-American Water Company*, Case No. 9482, Order, 8 July 1986 (page 22); also see *In the Matter of: Adjustment of Rates of Columbia Gas of Kentucky, Inc.* Case No. 10498, Order, 6 October 1989 (page 30). The Attorney General's recommendation is to exclude these expenses.

Mr. Majoros is providing a revised proposal to incorporate this adjustment. Please see Exhibit___(MJM-4) Updated, Schedule 11 for Adjustment 13, which is the AG's new membership expense adjustment. Adjustment 13 is carried forward to Exhibit___(MJM-1) Updated, Schedule 2. Both exhibits are attached to these responses.

KENTUCKY AMERICAN WATER COMPANY
FUTURE TEST YEAR ENDING NOVEMBER 30, 2008

AG Adjustment No. 13 (Update)

Remove Memberships

Line	Description		Amount	
1	Memberships to Rotary Club, Audubon Society, Lexington Forum and Bluegrass Trust	$	3,386	1/
2	Adjustment - Pre Tax	$	(3,386)	
3	Tax Rate		38.90%	
4	Tax Effect (L. 2 * L. 3)		1,317	
5	Adjustment - Post Tax (L. 2 + L. 4)	$	(2,069)	
6	Revenue Conversion Factor		1.65249	
7	Revenue Requirement (L. 5 * L. 6)	$	(3,419)	

Sources:
1/ See KAWC Exhibit 37, Schedule F-1.

KENTUCKY-AMERICAN WATER COMPANY

SUMMARY OF ATTORNEY GENERAL ADJUSTMENTS

Line No.	Major Group Classification	Company Forecasted Revenues & Expenses	AG Adj. 1 Depreciation Impact on Ratebase	AG Adj. 2 Cash Working Capital	AG Adj. 3 Consolidated Taxes	AG Adj. 4 Excess Management Fees	AG Adj. 5 Depreciation Expense	AG Adj. 6 Incentive Pay	AG Adj. 7 Group Insurance	AG Adj. 8 Bus. Devel. Portion of Mgmt. Fees	AG Adj. 9 Wastewater Technician	AG Adj. 10 Interest Synchronization	Total AG Original Adjustments
1													
2	**Operating Revenues**												
3	Water Sales	$ 49,242,905	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
4	Other Operating Revenues	3,760,392	-	-	-	-	-	-	-	-	-	-	-
5		$ 53,003,297	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
6	**Operating Expenses**												
7	Labor	$ 6,248,477	$ -	$ -	$ -	$ -	$ -	$ (252,550)	$ -	$ -	$ (12,497)	$ -	$ (265,047)
8	Purchased Water	477,463	-	-	-	-	-	-	-	-	-	-	-
9	Fuel and Power	2,986,277	-	-	-	-	-	-	-	-	-	-	-
10	Chemicals	1,505,218	-	-	-	-	-	-	-	-	-	-	-
11	Waste Disposal	262,237	-	-	-	-	-	-	-	-	-	-	-
12	Management Fees	6,201,194	-	-	-	(922,871)	-	-	-	(79,365)	-	-	(1,002,236)
13	Group Insurance	1,876,895	-	-	-	-	-	-	(114,696)	-	-	-	(114,696)
14	Pensions	502,684	-	-	-	-	-	-	-	-	-	-	-
15	Regulatory Expense	292,195	-	-	-	-	-	-	-	-	-	-	-
16	Insurance Other than Group	663,910	-	-	-	-	-	-	-	-	-	-	-
17	Customer Accounting	1,376,372	-	-	-	-	-	-	-	-	-	-	-
18	Rents	52,165	-	-	-	-	-	-	-	-	-	-	-
19	General Office Expense	475,196	-	-	-	-	-	-	-	-	-	-	-
20	Miscellaneous	3,002,289	-	-	-	-	-	-	-	-	-	-	-
21	Maintenance - Other	1,507,210	-	-	-	-	-	-	-	-	-	-	-
22													
23	Total O & M Expenses	$ 27,429,783	$ -	$ -	$ -	$ (922,871)	$ -	$ (252,550)	$ (114,696)	$ (79,365)	$ (12,497)	$ -	$ (1,381,979)
24													
25	Depreciation	$ 8,038,653	$ -	$ -	$ -	$ -	$ (416,463)	$ -	$ -	$ -	$ -	$ -	$ (416,463)
26	Amortization	450,971	-	-	-	-	-	-	-	-	-	-	-
27													
33	Total General Taxes	3,297,769	-	-	-	-	-	-	-	-	-	-	-
34													
42	Total Income Taxes	2,980,507	-	-	(894,416)	358,997	162,004	98,242	44,617	30,873	4,861	13,772	(181,050)
43													
44													
45	Total Operating Expenses	$ 42,197,683	$ -	$ -	$ (894,416)	$ (563,874)	$ (254,459)	$ (154,308)	$ (70,079)	$ (48,492)	$ (7,636)	$ 13,772	$ (1,979,492)
46													
47	Utility Operating Income	$ 10,805,614	$ -	$ -	$ 894,416	$ 563,874	$ 254,459	$ 154,308	$ 70,079	$ 48,492	$ 7,636	$ (13,772)	$ 1,979,492
48													
49													
50	Rate Base	$202,100,690	$ 413,549	$ (269,000)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 144,549
51													
52	KAWC Proposed ROR	8.64%											
53													
54	AG Recommended ROR	7.77%	7.77%	7.77%									
55													
56	NOI Effect	$ (1,758,276)	$ 32,133	$ (20,901)									
57													
58	KAWC Revenue Conversion Factor												
59													
60	AG Revenue Conversion Factor	1.65249	1.65249	1.65249	-1.65249	-1.65249	-1.65249	-1.65249	-1.65249	-1.65249	-1.65249	-1.65249	
61													
62	Incremental Revenue Requirement	$ (2,905,537)	$ 53,099	$ (34,539)	$ (1,478,016)	$ (931,798)	$ (420,492)	$ (254,993)	$ (115,805)	$ (80,133)	$ (12,618)	$ 22,759	$ (6,158,073)

Note: Difference from Schedule 1 due to rounding.

KENTUCKY-AMERICAN WATER COMPANY

SUMMARY OF ATTORNEY GENERAL ADJUSTMENTS

Line No.	Major Group Classification	Company Forecasted Revenues & Expenses	Additional Adjustments For Update: AG Adj. 11 AFUDC	AG Adj. 12 Uncollectibles Expense	AG Adj. 13 Memberships	AG Adj. 14 Additional Cash Working Capital	AG Adj. 15 Additional Interest Synchronization	Total AG Additional Adjustments	Total AG Adjustments	AG Updated Recommended Revenues and Expenses
1										
2	**Operating Revenues**									
3	Water Sales	$ 49,242,905	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 49,242,905
4	Other Operating Revenues	3,760,392	(185,889)	-	-	-	-	(185,889)	(185,889)	3,574,503
5		$ 53,003,297	$ (185,889)	$ -	$ -	$ -	$ -	$ (185,889)		$ 52,817,408
6	**Operating Expenses**									
7	Labor	$ 6,248,477	$ -	$ -	$ -	$ -	$ -	$ -	$ (265,047)	$ 5,983,430
8	Purchased Water	477,463	-	-	-	-	-	-	-	477,463
9	Fuel and Power	2,986,277	-	-	-	-	-	-	-	2,986,277
10	Chemicals	1,505,218	-	-	-	-	-	-	-	1,505,218
11	Waste Disposal	262,237	-	-	-	-	-	-	-	262,237
12	Management Fees	6,201,194	-	-	-	-	-	-	(1,002,236)	5,198,958
13	Group Insurance	1,876,895	-	-	-	-	-	-	(114,696)	1,762,199
14	Pensions	502,684	-	-	-	-	-	-	-	502,684
15	Regulatory Expense	292,195	-	-	-	-	-	-	-	292,195
16	Insurance Other than Group	663,910	-	-	-	-	-	-	-	663,910
17	Customer Accounting	1,376,372	-	(29,544)	-	-	-	(29,544)	(29,544)	1,346,828
18	Rents	52,165	-	-	-	-	-	-	-	52,165
19	General Office Expense	475,196	-	-	-	-	-	-	-	475,196
20	Miscellaneous	3,002,289	-	-	(3,386)	-	-	(3,386)	(3,386)	2,998,903
21	Maintenance - Other	1,507,210	-	-	-	-	-	-	-	1,507,210
22									-	
23	Total O & M Expenses	$ 27,429,783	$ -	$ (29,544)	$ (3,386)	$ -	$ -	$ (32,930)		$ 26,014,874
24										
25	Depreciation	$ 8,038,653	$ -	$ -	$ -	$ -	$ -	$ -	$ (416,463)	$ 7,622,190
26	Amortization	450,971	-	-	-	-	-	-	-	450,971
27										
33	Total General Taxes	3,297,769	-	-	-	-	-	-	-	3,297,769
34										
42	Total Income Taxes	2,980,507	(72,311)	11,493	1,317	-	1,768	(57,733)	(238,783)	2,741,724
43										
44										
45	Total Operating Expenses	$ 42,197,683	$ (72,311)	$ (18,051)	$ (2,069)	$ -	$ 1,768	$ (90,663)	$ (655,246)	$ 40,127,528
46										
47	Utility Operating Income	$ 10,805,614	$ (113,578)	$ 18,051	$ 2,069	$ -	$ (1,768)	$ (95,226)	$ 655,246	$ 12,689,880
48										
49										
50	Rate Base	$202,100,690	$ -	$ -	$ -	$ (131,000)	$ -	$ (131,000)	$ 13,549	$ 202,114,239
51										
52	KAWC Proposed ROR	8.64%								
53										
54	AG Recommended ROR	7.77%				7.77%				
55										
56	NOI Effect	$ (1,758,276)				$ (10,179)				
57										
58	KAWC Revenue Conversion Factor									
59										
60	AG Revenue Conversion Factor	1.65249	-1.65249	-1.65249	-1.65249	1.65249	-1.65249			
61										
62	Incremental Revenue Requirement	$ (2,905,537)	$ 187,687	$ (29,830)	$ (3,419)	$ (16,820)	$ 2,922			

Note: Difference from Schedule 1 due to rounding.

Response of Michael J. Majoros, Jr.

12. In all previous proceedings in which Kentucky-American applied for a rate adjustment using a fully forecasted test period, the Commission found that "slippage" adjustments were appropriate to account for the effect of capital construction budget variances for the 10 years previous to the forecasted period.

a. State whether the AG agrees with the use of slippage adjustments in rate proceedings in which a fully forecasted test period is used.

b. Refer to Kentucky-American's Response to Commission Staff's Third Information Request, Item 47. State whether the AG agrees with the slippage adjustments set forth in that response.

c. State the reasons why the AG witnesses have not proposed slippage adjustments or otherwise included such adjustments in their recommendations.

Response:

a. Yes.

b. Mr. Majoros assumes you are referring to the supplemental response to Staff 2-47. Mr. Majoros accepts those numbers.

c. Mr. Majoros did not propose a slippage adjustment because it appeared to him, based on KAWC's response to Staff 2-47, that the slippage adjustment would increase revenue requirements.

Case No. 2007-00143
Commission Staff's First Set of Information Requests
To The Attorney General

Response of Dr. J. Randall Woolridge

13. Refer to Direct Testimony of Dr. J. Randall Woolridge at 8 - 9. Explain why investors as a result of Jobs and Growth Tax Relief Reconciliation Act of 2003 would willingly give up that incremental increase in investment returns to ratepayers vis-à-vis lower equity returns awarded to utilities.

Response:

It is Dr. Woolridge's contention that the lowering of tax rates on dividend and capital gains income reduced investors' pre-tax return requirement relative to the pre-2003 years. If investors require lower returns due to a reduction in taxes, there is no reason to compensate them with a return for taxes which they do not have to pay.

Case No. 2007-00143
Commission Staff's First Set of Information Requests
To The Attorney General

Response of Dr. J. Randall Woolridge

14. Refer to Direct Testimony of Dr. J. Randall Woolridge at 27-29 and Exhibit JRW-6 at 3-5.

a. Explain why blending the mean and median values of ten and five and one year averages produces a meaningful estimate of growth rates.

b. Explain how blending projected estimates of earnings, dividends, and book value growth rates into a single number provides a meaningful estimate of growth rates.

Response:

a. Dr. Woolridge's objective is to find the central tendency for the figures shown. Means and medians are measures of central tendency for an array of numbers. Due to the presence of outliers, Dr. Woolridge is using both the means and medians. Growth over five- and ten- year periods are commonly provided to investors by Value Line and other investor information sources as indicators of historic growth.

b. According to the DCF model, DPS, EPS, and BVPS should all have the same rate of growth. Over short-term periods of time, these growth rates may differ, Dr. Woolridge is attempting to gauge an overall long-term rate of growth for all three.

Case No. 2007-00143
Commission Staff's First Set of Information Requests
To The Attorney General

Response of Dr. J. Randall Woolridge

15. Refer to Direct Testimony of Dr. J. Randall Woolridge at 30. Explain why, if Value Line's projected estimates of EPS are excessive and unrealistic, DPS and BVPS are acceptable for use in the analysis.

<u>Response:</u>

Dr. Woolridge evaluated Value Line's DPS growth rate forecasts as part of a larger study on dividend policy over twenty years ago. He discovered that Value Line DPS growth rate forecasts were superior to historic trends in forecasting future DPS. Dr. Woolridge is not aware of any other studies of Value Line DPS and/or BVPS growth rates.

Case No. 2007-00143
Commission Staff's First Set of Information Requests
To The Attorney General

Response of Dr. J. Randall Woolridge

16. Refer to Direct Testimony of Dr. J. Randall Woolridge, Exhibit JRW-7at 1. State whether the footnotes found at this page should refer to Exhibit JRW-7 rather than Exhibit JRW-8. If no, explain how Exhibit JRW-8 provides the information contained in the table.

Response:

The reference should be to JRW-7.

Response of Dr. J. Randall Woolridge

17. Refer to Direct Testimony of Dr. J. Randall Woolridge at 30 - 31, 38-53, Exhibit JRW-6, and Exhibit JRW-7.

a. State whether the DCF analysis gives approximately equal weight to historic and projected estimates of growth rates.

b. State whether the CAPM calculations give equal weighting between the historic and projected estimates of risk premiums.

c. Explain why the historical and projected risk premiums estimates should not be weighted equally for the analyses.

Response:

a. As stated in the testimony, the DCF analyses give more weight to the projected results and also take into consideration prospective internal growth.

b. The CAPM calculations give equal weighting to the results for (1) historical stock and bond returns, (2) ex ante models (also known as Puzzle Research, which are historic studies of expected returns), (3) Survey (which are current projected estimates of stock and bond returns), (4) the studies commissioned by the Social Security Administration (which are combination of historical and ex ante models), (5) Building Block Approaches (which use historical data and current inputs) and Other Studies. The only pure historical approach is (1), and the only pure forecasted approach is (3). The others combine both historical and expectational data in the analyses. Therefore, it is difficult to answer precisely whether an equal weighting has been given to both historical and projected estimates of risk premiums. It is clear that the results of numerous studies of the equity risk premium have been considered.

c. See response to 17-b.

Case No. 2007-00143
Commission Staff's First Set of Information Requests
To The Attorney General

Response of Dr. J. Randall Woolridge

18. Refer to Direct Testimony of Dr. J. Randall Woolridge at 38 – 53; Exhibit JRW-7, at 3.

a. Provide the references for <u>all</u> entries in Exhibit JRW-7.

b. Provide the historical data from "SBBI Yearbook 2007" that Dr. Woolridge used to derive the historical entries 6.50 and 5.00 percent.

c. (1) Explain the reference to "Puzzle Research."

(2) Provide a copy of each study to which Dr. Woolridge refers in this section of Exhibit JRW-7.

d. Provide a copy of each study to which Dr. Woolridge refers in the sections of Exhibit JRW-7 labeled "Surveys" and "Social Security."

e. (1) Explain why a substantial difference exists between the risk premium estimates of Ibbotson and Cheng and of Woolridge when the Building Block approach is used.

(2) Provide a copy of the Ibbotson and Cheng study.

f. Provide the portions of "SBBI Yearbook 2007" that:

(1) Discuss the estimation and use of ex ante approaches.

(2) Compare ex ante and historical approaches to calculating risk premiums.

g. For each entry in Exhibit JRW-7, other than the "SBBI Yearbook" estimate in the Historical subsection,

(1) State whether the entry is based upon a forecast or an expectation of a forward looking risk premium.

(2) State the entry's corresponding forecasted or forward looking period.

h. (1) Provide a copy of Mark H. Goedhart, Timothy M. Koller, and Zane D. Williams, "The Real Cost of Equity."

(2) Provide a copy of any updated study that Messrs. Goedhart, Koller and Williams have prepared on the cost of equity.

(3) State the risk premium that McKinsey and Company is currently using and provide the studies that it uses to support this risk premium.

i. For each entry appearing on Exhibit JRW-7 and published prior to 2006, explain why the entry is still relevant and appropriate for use in current risk premium analysis.

Response:

a.

SHOVEN, JOHN B. 2001. "What Are Reasonable Long-Run Rates of Return to Expect on Equities?" *Estimating the Real Rate of Return on Stocks over the Long Term,* presented to the Social Security Advisory Board, August.

BRAD CORNELL, "Equity Risk Premium Forum," AIMR, 11/8/01, pp. 38-41.

JOHN CAMPBELL, 2001. "Valuation Ratios and the Long-Run Stock Market Outlook: An Update." Working paper #8221, National Bureau of Economic Research. Forthcoming in *Advances in Behavioral Finance, Vol. II,* edited by Nicholas Barberis and Richard Thaler, Russell Sage Foundation, 2003.

PETER DIAMOND. 2001. "What Stock Market Returns to Expect for the Future: An Update," in *Estimating the Real Rate of Return on Stocks over the Long Term,* presented to the Social Security Advisory Board, August.

SOCIAL SECURITY ADVISORY BOARD. *Estimating the Real Rate of Return on Stocks over the Long Term,* 2001.

ROBERT HARRIS AND FELICIA MARSTON. 2001. "The Market Risk Premium: Expectational Estimates Using Analysts' Forecasts," *Journal of Applied Finance* 11(1): 6–16.

SIEGEL, JEREMY J. 1999. "The Shrinking Equity Premium," *Journal of Portfolio Management* 26(1): 10–17.

ARNOTT, ROBERT D., AND PETER L. BERNSTEIN. 2002. "What Risk Premium Is 'Normal'?" *Financial Analysts Journal* 58(2): 64–85.

IBBOTSON ASSOCIATES, 2007 SBBI Year Book.

EUGENE F. FAMA AND KENNETH R. FRENCH, "The Equity Premium," *The Journal of Finance*, (April 2002).

RICHARD DERRIG AND ELISHA ORR, "Equity Risk Premium: Expectations Great and Small," Working Paper (version 3.0), Automobile Insurers Bureau of Massachusetts, August 28, 2003.

DUKE UNIVERSITY AND CFO MAGAZINE CFO SURVEY, www.cfosurvey.org, March 2007.

ROGER IBBOTSON AND PENG CHEN, "Long Run Returns: Participating in the Real Economy," *Financial Analysts Journal*, January 2003.

ANTTI ILMANEN, Expected Returns on Stocks and Bonds," *Journal of Portfolio Management*, (Winter 2003), p. 11.

JAMES CLAUS AND JACOB THOMAS, "Equity Risk Premia as Low as Three Percent? Empirical Evidence from Analysts' Earnings Forecasts for Domestic and International Stock Market," *Journal of Finance*. (October 2001).

CORNELL, BRADFORD. 1999. *The Equity Risk Premium: The Long-Run Future of the Stock Market.* New York: John Wiley & Sons.

ELROY DIMSON, PAUL MARSH, AND MIKE STAUNTON, "New Evidence puts Risk Premium in Context," *Corporate Finance* (March 2003)

CONSTANTINIDES, GEORGE M. 2002. "Rational Asset Prices," *Journal of Finance* 57(4): 1567–91.

IVO WELCH, 2001/2005"The Equity Risk Premium Consensus Forecast Revisited," (September 2001). Cowles Foundation Discussion Paper No. 1325.

FEDERAL RESERVE BANK OF PHILADELPHIA, *Survey of Professional Forecasters,* February 13, 2007.

MARC H. GOEDHART, TIMOTHY M. KOLLER, AND ZANE D. WILLIAMs, "The Real Cost of Equity," *McKinsey on Finance* (Autumn 2002), p.14.

b. The Ibbotson 2007 results are provided on the CD in the file as 'Ibbotson Results 2007.'

c. Puzzle research is defined on page 39 of Dr. Woolridge's testimony.

d. The requested articles are provided on the CD.

e. (1) Ibbotson used historical inputs into his building blocks approach while Dr. Woolridge uses current inputs into his building blocks approach.

(2) The requested article is provide on the CD.

f. (1). In the 2007 Yearbook, there is no discussion of the estimation and use of ex ante approaches other than a reference to Ibbotson and Chen study. A copy of this study is provided on the CD.

(2) In the 2007 Yearbook, there is no comparison of the ex ante and historical approaches to calculating risk premiums other a reference to Ibbotson and Chen study. A copy of this study is provided on the CD.

g. (1) the requested information is provided in the article: RICHARD DERRIG AND ELISHA ORR, "Equity Risk Premium: Expectations Great and Small," Working Paper (version 3.0), Automobile Insurers Bureau of Massachusetts, August 28, 2003.

g. (2) See response to 18-g (1).

h. (1) The requested article is provide on the CD.

(2) To the best of Dr. Woolridge's knowledge, there is no updated study.

(3) Dr. Woolridge is unaware of the equity risk premium currently in use by McKinsey. However, as stated in the McKinsey study, they believe that 3.5-4.0 percent represents the long-term equity risk premium and that it has not changed significantly.

i. The only studies published from 2006 to the present are:

DUKE UNIVERSITY AND CFO MAGAZINE CFO SURVEY, www.cfosurvey.org, March 2007.

IBBOTSON ASSOCIATES, 2007 SBBI Year Book.

FEDERAL RESERVE BANK OF PHILADELPHIA, *Survey of Professional Forecasters,* February 13, 2007.

All others were published prior to 2006. Nonetheless, these studies are still relevant since they all use capital market and fundamental company data which goes back over fifty years. Hence, these studies do not derive equity risk premium which are not just relevant as of the date of publication but which are based on decades of economic data.