

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

IN THE MATTER OF:)	
)	
NOTICE OF ADJUSTMENT OF THE RATES OF)	CASE NO. 2008-00427
KENTUCKY-AMERICAN WATER COMPANY)	
EFFECTIVE ON AND AFTER NOVEMBER 30, 2008)	

**DIRECT JOINT TESTIMONY OF NICK O. ROWE
AND MICHAEL A. MILLER
April 3, 2009**

1 **1. Q: MR. ROWE, PLEASE STATE YOUR NAME, TITLE AND BUSINESS**
2 **ADDRESS.**

3 A: My name is Nick O. Rowe. My titles are President of Kentucky-American Water
4 Company (“KAW”) and Senior Vice President of the Eastern Division of
5 American Water Works Company, Inc. My business address is 2300 Richmond
6 Road, Lexington, Kentucky 40502.

7 **2. Q: MR. MILLER, PLEASE STATE YOUR NAME, TESTIMONY AND**
8 **BUSINESS ADDRESS.**

9 A: My name is Michael A. Miller. My title is Assistant Treasurer of KAW. My
10 business address is 1600 Pennsylvania Avenue, Charleston, West Virginia 25302.

11 **3. Q: WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

12 A: Our joint testimony is filed in support of the Settlement Agreement, Stipulation
13 and Recommendation (“Agreement”) filed with the Kentucky Public Service
14 Commission (“Commission”) on April 1, 2009 in this proceeding. Our testimony
15 will explain how the Agreement is fair, just and reasonable.

16 **4. Q: PLEASE EXPLAIN HOW THE TOTAL AMOUNT OF THE INCREASE**
17 **IN REVENUES FOR KAW AS PROPOSED IN THE AGREEMENT CAN**
18 **BE CONSIDERED FAIR, JUST AND REASONABLE.**

19 A: The initial proposal by KAW in this proceeding, which was subsequently revised,
20 represents a fair, just and reasonable outcome. Since this proceeding commenced,
21 substantial data has been exchanged and the parties have engaged in extensive
22 negotiations in an attempt to arrive at an alternative outcome that is fair, just and

1 reasonable to KAW's customers and its shareholders and an outcome that the
2 Commission would, and should, approve. The compromise of revenues and rates
3 that has resulted from these negotiations reflects the present best judgment of the
4 parties (including their respective outside experts) as to what is fair, just and
5 reasonable for KAW's customers and shareholders. These rates will produce
6 sufficient revenue for KAW to operate and provide the high level of service its
7 customers expect and deserve.

8 KAW's position remains that the entire revised increase it has sought in this
9 proceeding is appropriate to maintain its earnings at a level that allows KAW an
10 opportunity to earn a fair, just and reasonable return on its investment.
11 Nonetheless, the nature of the ratemaking process is such that the Agreement
12 produces a fair, just and reasonable outcome as a result of the compromise
13 reached by the parties.

14 **5. Q: WHY WOULD THE PARTIES BE WILLING TO REACH A**
15 **COMPROMISE?**

16 A: Each of the parties to the Agreement has vigorously pursued its respective
17 positions in testimony, exhibits and responses to data requests. However, despite
18 the sincerity of these individual positions, the parties recognize that the final
19 outcome in this proceeding would likely result in a decision with which no party
20 would be totally satisfied. The parties further recognize that the very nature of
21 litigation entails both risk and cost. By reaching this compromise, each party has
22 determined that the proposed Agreement is preferable to other, less favorable
23 outcomes and avoids the costs that would result from continued litigation.

1 Through negotiation, each party was able to prioritize its goals in this proceeding
2 and ensure that those priorities are reflected in the Agreement.

3 **6. Q: HOW DOES A COMPROMISE PRODUCE A FAIR, JUST AND**
4 **REASONABLE CHANGE IN REVENUES?**

5 A: Each of the parties to this proceeding represents a unique constituency. By
6 pursuing the positions of the respective constituencies in negotiations, each party
7 has ensured that the priorities of its constituencies have been met. Each party has
8 freely and voluntarily agreed to the concessions it has made in order to ensure its
9 priorities are reflected in the Agreement, which provides for a fair, just and
10 reasonable change in rates. In other words, the Agreement is a fair, just and
11 reasonable settlement because each constituency has been vigorously represented
12 in the negotiations and, through representation or direct involvement, has freely
13 agreed to the Agreement.

14 **7. Q: WHAT EVIDENCE IS THERE FOR THE COMMISSION THAT EACH**
15 **CONSTITUENCY WAS VIGOROUSLY REPRESENTED IN THE**
16 **NEGOTIATIONS THAT LED TO THIS SETTLEMENT?**

17 A: The Agreement itself reveals the sincerity of the negotiations on all sides. The
18 record in this proceeding clearly states the positions of the parties. The
19 Commission need only review the positions taken by the parties in this case and
20 compare those positions to the Agreement to determine if each party was
21 vigorously represented in negotiations and made appropriate concessions to
22 ensure its priorities were reflected in the Agreement. Any settlement must be
23 viewed in its entirety rather than evaluated on the basis of any of its individual

1 components. This Agreement was negotiated in the context of its overall result
2 and impact on customers and shareholders instead of on an issue-by-issue basis.
3 In fact, the only disputed rate case issue addressed specifically in the Agreement
4 is the issue of the ratemaking and accounting treatment of the capital expenditures
5 related to the construction of Kentucky River Station II and its associated
6 facilities (“KRS II”), which was the subject of Case No. 2007-00134. That issue
7 is discussed in more detail below.

8 **8. Q: PLEASE BRIEFLY DESCRIBE THE TERMS OF THE AGREEMENT**
9 **AND ITS EXHIBITS.**

10 A: The Agreement offered to the Commission for its consideration and approval
11 permits KAW to adjust its rates to recover an additional \$10.3 million in annual
12 revenue compared to current rates, beginning June 1, 2009. The increased
13 revenue shall be reflected in increases to customer charges associated with
14 KAW’s various tariff sheets. The affected tariff sheets are attached to the
15 Agreement (as Exhibit A) in their proposed form. The proposed tariff sheets
16 show the rates that will be implemented on June 1, 2009, if the Agreement is
17 approved. Exhibit B to the Agreement contains the proof-of-revenue information.
18 The Exhibits to the Agreement are considered a part of the Agreement and have
19 been agreed to by all parties.

1 **9. Q: PLEASE DESCRIBE WHY THE TARIFFS THAT HAVE BEEN**
2 **MODIFIED BY VIRTUE OF THE AGREEMENT ARE FAIR, JUST AND**
3 **REASONABLE.**

4 A: As a part of the Agreement, the parties have agreed upon the affected tariff sheets
5 that comprise Exhibit A to the Agreement. Those tariff sheets ensure the interests
6 of the constituencies represented by each party have been prioritized and
7 protected in the Agreement. The tariffs themselves are the means by which KAW
8 can produce the agreed upon level of revenue – a level that is necessary for KAW
9 to meet its obligations.

10 **10. Q: PLEASE DESCRIBE THE PROOF-OF-REVENUE SHEETS THAT ARE**
11 **ATTACHED TO THE AGREEMENT AS EXHIBIT B.**

12 A: As a part of the Agreement, all of the parties have agreed upon the proof-of-
13 revenue sheets that are Exhibit B to the Agreement. Those sheets detail the rate
14 design of the \$10.3 million annual rate adjustment.

15 **11. Q: PLEASE DESCRIBE PARAGRAPH NO. 4 OF THE AGREEMENT THAT**
16 **ADDRESSES THE ISSUE OF THE RATEMAKING AND ACCOUNTING**
17 **TREATMENT OF THE CAPITAL EXPENDITURES RELATED TO THE**
18 **CONSTRUCTION OF KRS II?**

19 A: KAW is in the process of constructing KRS II for which the Commission issued a
20 certificate of public convenience and necessity in Case No. 2007-00134. In the
21 current rate case, KAW proposed that approximately \$66 million of that
22 approximately \$162 million project should be included in the new rates that result
23 from this case. Although KRS II is not yet online, KAW expects it to be
24 operational in 2010. Therefore, KAW’s proposal has been to include \$66 million
25 of KRS II capital expenditures in rate base (without a corresponding offset for

1 Allowance for Funds Used During Construction (“AFUDC”)) effective June 1,
2 2009, with the total amount of KRS II capital expenditures to be included in rate
3 base in KAW’s next general water rate case. One of the AG’s expert witnesses,
4 Mr. Robert Henkes, opined that no portion of KRS II capital expenditures should
5 be included in rate base without fully offsetting that amount via AFUDC. In
6 reaching the Agreement, the parties have recognized the need to avoid “rate
7 shock,” and, thus, have agreed to include \$20.2 million of KRS II capital
8 expenditures in rate base effective June 1, 2009, without a corresponding AFUDC
9 offset. Therefore, a portion of the KRS II expenditures are reflected in the rates
10 proposed in the Agreement. In KAW’s next general water rate case, it plans to
11 seek ratemaking treatment for all KRS II capital expenditures.

12 **12. Q: PLEASE DESCRIBE THE PART OF THE SETTLEMENT AGREEMENT**
13 **THAT CALLS FOR KAW TO INCREASE ITS CONTRIBUTION TO THE**
14 **HELP TO OTHERS PROGRAM.**

15 A: KAW has agreed to increase its annual contribution to the Help To Others
16 Program beginning in 2010. The annual contribution will increase from \$50,000
17 to \$60,000, which contribution has been and will be paid by KAW’s owners and
18 not KAW’s customers. Although the Commission has no jurisdiction over the
19 Help To Others Program, KAW looks forward to making the agreed upon
20 increased contribution.

1 **13. Q: IS KAW IN THE PROCESS OF PUBLISHING PUBLIC NOTICE OF THE**
2 **HEARING IN THIS CASE, WHICH IS SCHEDULED TO BEGIN ON**
3 **APRIL 14, 2009?**

4 A: Yes. KAW is in the process of publishing the public notice in newspapers
5 throughout its service area. Affidavits demonstrating the publications are being
6 gathered at this time and will be submitted to the Commission when the complete
7 documentation has been compiled.

8 **14. Q: ARE THERE ANY OTHER MATTERS YOU WISH TO ADDRESS AT**
9 **THIS TIME?**

10 A: Yes. In closing, please note that all of the parties have expended considerable
11 effort to reach the terms that form the basis of the Agreement. The parties agree
12 that the Agreement is reasonable, produces rates that are fair, and is in the best
13 interests of all concerned. Together, we submit the Agreement for the
14 consideration of the Commission and urge that it be approved in its entirety.

15 **15. Q: DOES THIS CONCLUDE YOUR DIRECT TESTIMONY IN SUPPORT OF**
16 **THE AGREEMENT?**

17 A: Yes.