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October 14, 2009

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David Spenard, Esq.
Office of Attorney General
Suite 200
1024 Capital Center Drive
Frankfort, Kentucky 40601-8204

Re: Case No. 2009-00359
Kentucky-American Water Company

Gentlemen:

The enclosed memorandum has been filed in the record of the above-referenced case. Any comments regarding this memorandum's contents should be submitted to the Commission within five days of receipt of this letter. Any questions regarding this memorandum should be directed to Gerald Wuetcher, Executive Advisor, at (502) 564-3940, Extension 259.

Sincerely,

A handwritten signature in black ink, appearing to read "Jeff Derouen".

Jeff Derouen
Executive Director

gw
Enclosure

INTRA-AGENCY MEMORANDUM
KENTUCKY PUBLIC SERVICE COMMISSION

TO: Case File No. 2009-00359

FROM: Gerald Wuetcher *GEW*
Executive Advisor

DATE: October 14, 2009

RE: Conference of October 13, 2009

On October 13, 2009, the Commission held a conference in this case in the Commission's offices in Frankfort, Kentucky. Present were:

Deb Degillio	-	Kentucky-American Water Company
Lindsey Ingram III	-	Kentucky-American Water Company
A.W. Turner	-	Kentucky-American Water Company
Mark Frost	-	Commission Staff
Sam Reid	-	Commission Staff
Gerald Wuetcher	-	Commission Staff

David Spenard of the Office of Attorney General participated in the conference by telephone. Commission Staff had established the conference on its own motion.

Beginning the conference, Mr. Wuetcher noted that Kentucky-American Water Company's ("KAWC") Request indicated that KAWC's dividend payments for the first and second quarters of Calendar Year 2009 each represented more than 5 percent of KAWC's retained earnings as of December 31, 2008 and that, in the case of each payment, KAWC had not applied for Commission approval of the payment. These actions, Mr. Wuetcher stated, appeared to violate Condition 32 of the Commission's Order of December 20, 2002 in Case No. 2002-00317.

Mr. Ingram agreed that KAWC had violated Condition 32 in making the two dividend payments. He stated that the matter "had fallen through the cracks" and KAWC had not willfully or knowingly violated Condition 32. Mr. Ingram explained that KAWC had established mechanisms to ensure that all requirements established by the Order of December 20, 2002 that had a specific time deadline were met. Condition 32 had no such deadline. Usually, the dividend payments in the first and second quarter were not of sufficient size to meet the threshold level of Condition 32. Generally such approval was required only in the last two quarters of a calendar year. It was in preparing the request for approval for KAWC's third quarter dividend payment that KAWC officials recognized that the earlier two payments met the threshold level of Condition 32.

Mr. Ingram stated that KAWC has implemented new safeguards to prevent recurrence of an unauthorized payment. First, the question of whether the Condition 32 threshold will now be placed on the agenda of each KAWC Board of Director's meeting. Board Members will therefore be required to address the issue at any meeting on which the payment of dividends is also an agenda item. Second, KAWC's Secretary and Treasurer will also raise the issue at any board meeting in which the issue of dividend payments appears. Third, a KAWC employee within KAWC's Finance Department has been assigned responsibility to review all dividend payments and perform the required test to determine whether the threshold level has been met. Fourth, whenever KAWC's Board of Directors approves a dividend payment, outside counsel will be informed and will separately perform the required test to determine if the threshold level has been met. Fifth, American Water Works Company has amended its processes for cash transfers with KAWC and will also perform the threshold test to ensure compliance with Condition 32 as a prerequisite for any transfer of cash funds from KAWC to American Water Works Company.

Mr. Wuetcher noted that the current incident marked the second occasion on which KAWC had failed to comply with Condition 32. On the earlier occasion, he noted, the Commission had indicated that future failures to comply would subject the water utility to administrative sanctions. He inquired about KAWC's position on the imposition of sanctions in the current case.

Mr. Ingram stated that KAWC did not believe that sanctions were appropriate. He noted that KAWC had self-reported the violation. He further stated that, while KAWC had violated Condition 32, it had not violated the underlying principle behind Condition 32. KAWC, he stated, had not changed or altered its dividend payment policy nor had the payments in question represented any change or deviation from the policy that KAWC had in place prior to the Order of December 20, 2002. KAWC did not knowingly or willfully violate Condition 32. KAWC would be willing to acknowledge that a violation occurred but did not believe that a penalty or other sanction was merited.

Mr. Spenard stated that evidence did not indicate that a willful violation of Condition 32 had occurred, but did not address the subject of administrative sanctions.

Mr. Wuetcher suggested that the parties and Commission Staff attempt to resolve the issue of non-compliance with Condition 32 in this proceeding. Mr. Ingram stated that KAWC preferred to address this issue in the current proceeding than have it presented in a new proceeding. He inquired whether the Commission could proceed to take final action on KAWC's request regarding the third quarter dividend payment while continuing to examine the earlier dividend payments in this proceeding. Mr. Wuetcher stated that he would raise this issue with the Commission.

The parties agreed to reconvene on October 22, 2009 at 2:00 p.m. by conference call to discuss possible means of resolving the violations of Condition 32. The conference then adjourned.

cc: Parties of Record