

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

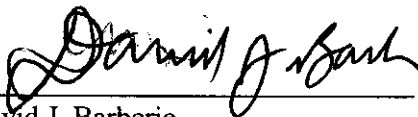
APPLICATION OF KENTUCKY-AMERICAN)
WATER COMPANY FOR AN ADJUSTMENT OF) CASE NO. 2010-00036
RATES SUPPORTED BY A FULLY)
FORECASTED TEST YEAR)

**LEXINGTON-FAYETTE URBAN COUNTY
GOVERNMENT'S RESPONSES TO FIRST
INFORMATION REQUESTS OF COMMISSION STAFF**

Comes now the Lexington-Fayette Urban County Government ("Lexington"), by counsel and submits the following responses to the First Information Requests of Commission Staff.

Respectfully submitted,

BY:



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FILING NOTICE AND CERTIFICATE

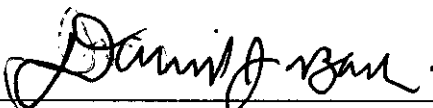
In accordance with Ordering Paragraph No. 5 of the Commission's February 16, 2010 Order, this is to certify that Lexington-Fayette Urban County Government's July 8, 2010 electronic filing of these data requests is a true and accurate copy of the documents to be filed in paper medium; that the electronic filing has been transmitted to the Commission on July 8, 2010; that an original and one copy of the filing will be delivered to the Commission on July 8, 2010; and that, on July 8, 2010, notification of the electronic filing will be provided to the Commission and the following via electronic mail:

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ATTORNEY FOR LEXINGTON-FAYETTE
URBAN COUNTY GOVERNMENT

**Lexington-Fayette Urban County Government's Responses
to First Information Request of Commission Staff
Case No. 2010-00036**

WITNESS RESPONSIBLE:

Richard A. Baudino
Counsel

1. Refer to the Direct Testimony of Richard A. Baudino at 4. Provide a copy of the article referenced in footnote 1.

Response:

Please refer to the attached page from the SBBI Yearbook.

Chapter 1 Highlights of the 2008 Markets and the Past Decade

Events of 2008

In one of the worst years since the Great Depression, the stock market declined significantly in 2008. Both large company stocks and small company stocks declined approximately 37% and experienced remarkable volatility.

The bond market was characterized by a flight to safety, as investors pulled money out of corporate bonds and purchased U.S. Treasuries. On a month-end basis, long-term government bond yields fell to levels not seen since June 1956, and intermediate-term government bond yields fell to levels not seen since December 1949. The Consumer Price Index (a measure of inflation) increased 4.18 percent in the first half of 2008, but declined 3.92 percent in the second half, the largest June to December decrease since 1930.

2008 was a very volatile year in securities markets and a very tumultuous year for business in general. Figure 1.1 displays a timeline of the major events of the year. The purchase of Bear Stearns by JP Morgan made many aware of the tremendous pressure the investment banking industry was facing; however, it wasn't until Lehman Brothers collapsed later in the year that the true weakness

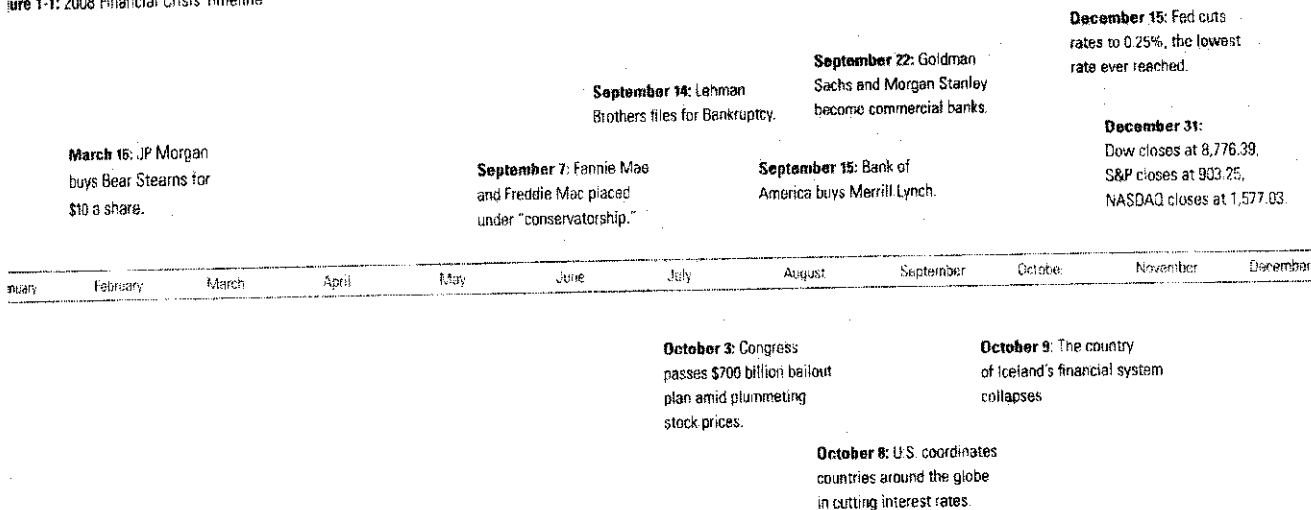
of the sector became evident to all. Perhaps even more emblematic was the passage of the \$700 billion Emergency Economic Stimulus plan by Congress in the midst of a plummeting stock market. Throughout the year, the government of the United States, as well as others around the globe, took unprecedented action to avoid a total breakdown of financial markets.

Gross Domestic Product (GDP)

The United States Real Gross Domestic Product (GDP), a measure of the market value of all goods and services produced within the U.S., grew at an estimated 1.3 percent in 2008, compared with 2.0 percent in 2007. The first half of 2008 was positive, the second half of 2008 was negative, with quarters one, two, three and four coming in at 0.9 percent, 2.8 percent, -0.5 percent, and an estimated -3.8 percent, respectively.

Since 1970, there have been seven occurrences of lower annual GDP since than what was experienced in 2008: 2001 (0.8 percent), 1991 (-0.2 percent), 1982 (-1.9 percent), 1980 (-0.2 percent), 1975 (-0.2 percent), 1974 (-0.5 percent), and 1970 (0.2 percent). On a quarterly basis since 1970, there have been five occurrences of lower GDP than what was experienced in the fourth quarter of 2008, the most recent being the first quarter of 1982 (-6.4 percent). Overall, there have been 21 occurrences of negative GDP on a quarterly basis since 1970.

Figure 1-1: 2008 Financial Crisis Timeline



**Lexington-Fayette Urban County Government's Responses
to First Information Request of Commission Staff
Case No. 2010-00036**

WITNESS RESPONSIBLE:

Richard A. Baudino
Counsel

2. Refer to the Direct Testimony of Richard A. Baudino at 30 and Exhibit RAB-8.
 - a. Explain why it is appropriate to use five-year Treasury note yields in the CAPM analysis.
 - b. Explain why 30-year Treasury bond yields should not be considered in the CAPM analysis.

Response:

- a. Mr. Baudino used the 5-year Treasury bond in order to more closely approximate a short-term risk-free rate of return.
- b. The 30-year Treasury bond may also be used in the CAPM analysis. There is not a significant difference in the yields between the 20-year and 30-year Treasury bonds.

CERTIFICATION

This is to certify that I supervised the preparation of Lexington-Fayette Urban County Government's responses to First Information Requests of Commission Staff and that the responses are true and accurate to the best of my knowledge, information and belief formed after reasonable inquiry.



David J. Barberie
July 8, 2010

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