# Kentucky-American Water Company
## Case No. 2010-00036
## Exhibit RCS-1
## Accompanying the Direct Testimony of Ralph Smith

| Number | Description | No. of Pages | Revised | Exhibit Page No. |
|---|---|---|---|---|
| | **Revenue Requirement Summary Schedules** | | | |
| A | Calculation of Revenue Deficiency (Sufficiency) | 2 | Yes | 2-3 |
| A-1 | Gross Revenue Conversion Factor | 1 | Yes | 4 |
| B | Adjusted Rate Base | 1 | Yes | 5 |
| B.1 | Summary of Rate Base Adjustments | 1 | Yes | 6 |
| C | Adjusted Net Operating Income | 1 | Yes | 7 |
| C.1 | Summary of Net Operating Income Adjustments | 2 | Yes | 8-9 |
| D | Capital Structure and Cost Rates | 1 | | 10 |
| | | | | |
| | **Rate Base Adjustments** | | | |
| B-1 | Construction Work in Progress | 1 | | 11 |
| B-2 | Acquisition Adjustment Double Count | 1 | | 12 |
| B-3 | Cash Working Capital | 3 | | 13-15 |
| B-4 | Labor Costs in Deferred Maintenance | 1 | | 16 |
| B-5 | Accumulated Depreciation | 1 | | 17 |
| B-6 | Accumulated Deferred Income Taxes - Deferred Maintenance | 1 | | 18 |
| B-7 | Accumulated Deferred Income Taxes - Major Tax Accounting Change | 1 | Yes | 19 |
| | | | | |
| | **Net Operating Income Adjustments** | | | |
| C-1 | Income Tax Expense - Interest Synchronization | 1 | Yes | 20 |
| C-2 | Income Tax Expense - Consolidated Tax Savings | 1 | | 21 |
| C-3 | Allowance for Funds Used During Construction | 1 | | 22 |
| C-4 | Incentive Compensation Expense | 1 | | 23 |
| C-5 | Stock-Based Compensation Expense | 1 | | 24 |
| C-6 | Affiliate Management Fees - Excess Over Current Budget | 1 | | 25 |
| C-7 | Affiliate Management Fees - Business Development Expense | 1 | | 26 |
| C-8 | Affiliate Management Fees - Donations and Miscellaneous Expenses | 1 | | 27 |
| C-9 | Pension and OPEB Expense Correction | 1 | | 28 |
| C-10 | Rate Case Expense - Prior Rate Cases | 1 | | 29 |
| C-11 | Rate Case Expense - Current Rate Case | 2 | | 30-31 |
| C-12 | Depreciation Expense | 2 | | 32-33 |
| C-13 | Capitalization Rate | 1 | | 34 |
| C-14 | Employee Party, Outing and Gift Expenses | 1 | | 35 |
| C-15 | Vacancies and Over-projection of Pay Increases | 2 | | 36-37 |
| C-16 | KRS Lagoon Cleaning Expense Normalization | 1 | | 38 |
| C-17 | Uncollectibles Expense | 1 | | 39 |
| C-18 | Payroll Tax Expense | 1 | | 40 |
| | | | | |
| | Total Pages (Including Contents Page) | 40 | | |

(Direct)
ATTY GEN. EXHIBIT 1

Kentucky-American Water Company
Calculation of Revenue Deficiency (Sufficiency)

Test Year Ended September 30, 2011

Exhibit RCS-1
Schedule A
Case No. 2010-00036
Page 1 of 2
Revised

| Line No. | Description | Reference | Per Company (A) | Per AG (B) | Difference (C) |
|---|---|---|---|---|---|
| 1 | Adjusted rate base | Sch B | $ 362,672,028 | $ 349,969,953 | $ (12,702,075) |
| 2 | Rate of return | Sch D | 8.580% | 7.500% | |
| 3 | Net operating income required | | $ 31,117,260 | $ 26,247,746 | $ (4,869,514) |
| 4 | Rounding | | $ - | | |
| 5 | Net operating income required | | $ 31,117,260 | $ 26,247,746 | $ (4,869,514) |
| 6 | Adjusted net operating income | Sch C | $ 15,473,267 | $ 18,184,592 | $ 2,711,325 |
| 7 | Net operating income deficienc | | $ 15,643,993 | $ 8,063,154 | $ (7,580,839) |
| 8 | Gross revenue conversion factor | Sch A-1 | 1.6522819 | 1.6515716 | |
| 9 | Revenue deficiency (Sufficiency) | | $ 25,848,286 | $ 13,316,876 | $ (12,531,410) |
| 10 | Difference | | $ - | | $ - |
| 11 | Revenue increase | | $ 25,848,286 | $ 13,316,876 | $ (12,531,410) |
| 12 | Adjusted operating revenues | Sch C | $ 68,523,626 | $ 67,877,446 | $ (646,180) |
| 13 | Revenue requiremen | Sch C | $ 94,371,912 | $ 81,194,322 | $ (13,177,590) |
| 14 | Revenue increase, percen | | 37.7% | 19.6% | |

Notes and Source

Col.A: Company's filing, Exhibit No. 37, Schedule A
Col.B: See referenced schedules
Col.C: Col B - Col. A

Kentucky-American Water Company
Revenue Requirement Reconciliation

Test Year Ended September 30, 2011

Exhibit RCS-1
Schedule A
Case No. 2010-00036
Page 2 of 2
Revised

| Line No. | Description | Exhibit RCS-1 Schedule Reference | Component | AG Adjustments (A) | AG Multiplier (B) | AG Revenue Requirement Amount (C) |
|---|---|---|---|---|---|---|
| 1 | | D | ROR Difference | | -1.0800% | |
| 2 | **Rate Base** | A-1 | GRCF | | x 1.651572 | |
| 3 | Rate Base per KAWC's Filing | B | | $ 362,672,028 | -1.784% | $ (6,468,971) |
| 4 | | D | Rate of Return | | 7.500% | |
| 5 | **Effect of AG Adjustments to Rate Base** | A-1 | GRCF | | x 1.651572 | |
| | | | | Sch B.1 | | |
| 6 | Construction Work in Progress | B-1 | | $ (9,463,931) | 12.39% | $ (1,172,277) |
| 7 | Acquisition Adjustment Double Count | B-2 | | $ (2,342) | 12.39% | $ (290) |
| 8 | Cash Working Capital | B-3 | Revised | $ (980,000) | 12.39% | $ (121,391) |
| 9 | Labor Costs in Deferred Maintenance | B-4 | | $ (45,500) | 12.39% | $ (5,636) |
| 10 | Accumulated Depreciation | B-5 | | $ 164,801 | 12.39% | $ 20,414 |
| 11 | ADIT - Deferred Maintenance | B-6 | | $ 17,700 | 12.39% | $ 2,192 |
| 12 | ADIT - Major Tax Accounting Change | B-7 | Revised | $ (2,392,803) | 12.39% | $ (296,391) |
| 13 | Total AG Rate Base Adjustments | | | $ (12,702,075) | | |
| 14 | **AG Adjusted Original Cost Rate Base** | B | | $ 349,969,953 | | |
| 15 | **Net Operating Income** | | Pre-Tax Operating Income Amount | NOI Amount Sch C.1 | AG GRCF Sch. A-1 | |
| | **Effect of AG Adjustments on NOI** | | | | | |
| 16 | Income Tax Expense - Interest Synchronization | C-1 | $ - | $ (283,222) | 1.651572 | $ 467,761 |
| 17 | Income Tax Expense - Consolidated Tax Savings | C-2 | $ - | $ 1,361,624 | 1.651572 | $ (2,248,819) |
| 18 | Allowance for Funds Used During Construction | C-3 | $ (646,180) | $ (394,816) | 1.651572 | $ 652,067 |
| 19 | Incentive Compensation Expense | C-4 | $ 786,516 | $ 480,561 | 1.651572 | $ (793,681) |
| 20 | Stock-Based Compensation Expense | C-5 | $ 206,436 | $ 126,132 | 1.651572 | $ (208,316) |
| 21 | Affiliate Management Fees - Excess Over Current Budget | C-6 | $ 133,057 | $ 81,298 | 1.651572 | $ (134,269) |
| 22 | Affiliate Management Fees - Business Development Expense | C-7 | $ 198,342 | $ 121,187 | 1.651572 | $ (200,149) |
| 23 | Affiliate Management Fees - Donations and Miscellaneous Expenses | C-8 | $ 65,793 | $ 40,199 | 1.651572 | $ (66,392) |
| 24 | Pension and OPEB Expense Correction | C-9 | $ 305,468 | $ 186,641 | 1.651572 | $ (308,251) |
| 25 | Rate Case Expense - Prior Rate Cases | C-10 | $ 148,128 | $ 90,506 | 1.651572 | $ (149,477) |
| 26 | Rate Case Expense - Current Rate Case | C-11 | $ 66,288 | $ 40,502 | 1.651572 | $ (66,893) |
| 27 | Depreciation Expense | C-12 | $ 654,031 | $ 399,613 | 1.651572 | $ (659,989) |
| 28 | Capitalization Rate | C-13 | $ 358,551 | $ 219,075 | 1.651572 | $ (361,818) |
| 29 | Employee Party, Outing and Gift Expenses | C-14 | $ 25,070 | $ 15,318 | 1.651572 | $ (25,299) |
| 30 | Vacancies and Over-projection of Pay Increases | C-15 | $ 246,923 | $ 150,870 | 1.651572 | $ (249,173) |
| 31 | KRS Lagoon Cleaning Expense Normalization | C-16 | $ 12,376 | $ 7,561 | 1.651572 | $ (12,488) |
| 32 | Uncollectibles Expense | C-17 | $ 27,589 | $ 16,857 | 1.651572 | $ (27,841) |
| 33 | Payroll Tax Expense | C-18 | $ 84,155 | $ 51,419 | 1.651572 | $ (84,922) |
| 33 | Total AG Adjustments to Operating Income | C.1 | $ 2,672,543 | $ 2,711,325 | | |
| 34 | Net Operating Income per Company Filing | C | | $ 15,473,267 | | |
| 35 | **AG Adjusted Net Operating Income** | C | | $ 18,184,592 | | |
| | **Gross Revenue Conversion Factor Difference:** | | | | | |
| 36 | Per AG | A-1 | | | 1.651572 | |
| 37 | Per Company | A-1 | | | 1.652282 | |
| 38 | Difference | | | | -0.000710 | |
| 39 | Company Adjusted NOI Deficiency | A | | | $ 15,643,993 | |
| 40 | GRCF Difference | | | | | $ (11,109) |
| 41 | AG REVENUE REQUIREMENT ADJUSTMENTS ABOVE | | | | | $ (12,531,408) |
| 42 | Company Requested Base Rate Revenue Increase | A | | | | $ 25,848,286 |
| 43 | Reconciled Revenue Requirement | | | | | $ 13,316,878 |
| 44 | Revenue Requirement Calculated on Schedule A | A | | | | $ 13,316,876 |
| 45 | Difference Not Accounted for Above | A | | | | $ 2 |
| 46 | Schedule A, line 10 difference | | | | | $ - |
| 47 | Unreconciled Difference | | | | | $ 2 |

Notes and Source
Pre-tax return computed using Gross Revenue Conversion Factor

Kentucky-American Water Company
Gross Revenue Conversion Factor

Test Year Ended September 30, 2011

Exhibit RCS-1
Schedule A-1
Case No. 2010-00036
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Revised

| Line No. | Description | Reference | Tax Rates | Per Company (A) | Per AG (B) |
|---|---|---|---|---|---|
| 1 | Operating Revenues | | | 100.0000% | 100.0000% |
| 2 | Uncollectible Accounts Expense | Notes A&B | | 0.7836% | 0.7410% |
| 3 | PSC Fees | Note A | | 0.1618% | 0.1618% |
| 4 | Income Before State Taxes | | | 99.0546% | 99.0972% |
| 5 | Less: State Income Taxes | Note A | 6.00% | 5.9433% | 5.9458% |
| 6 | Income Before Federal Income Taxes | | | 93.1113% | 93.1514% |
| 7 | Less: Federal Income Taxes | Note A | 35.00% | 32.5890% | 32.6030% |
| 8 | Operating Income Percentage | | | 60.5224% | 60.5484% |
| 9 | Gross Revenue Conversion Factor | | | 1.6522817 | 1.6515716 |
| 10 | Rounding | | | 0.0000002 | |
| 11 | Gross Revenue Conversion Factor | Note A | | 1.6522819 | 1.6515716 |

Notes and Source

[A] KAWC Exhibit 37, Schedule H

[B] AG recommended Uncollectible Factor is based on a three-year average for 2007-2009 as shown on Schedule C-17

| | | | | | |
|---|---|---|---|---|---|
| Col. B: | Derived from Column A | | | | |
| 10 | Combined state and federal income tax rate | | (L5 + L7) / L4 | 38.9000% | 38.9000% |

**Components of Base Rate Revenue Change**

| | | Percent | Per AG |
|---|---|---|---|
| 11 | Revenue Change | | $ 13,316,876 |
| | Change in Expenses and Net Operating Income: | | |
| 12 | Uncollectible Accounts Expense | 0.74100% | $ 98,678 |
| 13 | PSC Fees | 0.16180% | $ 21,547 |
| 14 | State Income Taxes | 5.9458% | $ 791,799 |
| 15 | Federal Income Taxes | 32.6030% | $ 4,341,698 |
| 16 | Net Operating Income | 60.5484% | $ 8,063,154 |
| 17 | Total Revenue Change | 100.00000% | $ 13,316,876 |

Kentucky-American Water Company
Adjusted Rate Base

Test Year Ended September 30, 2011

Exhibit RCS-1
Schedule B
Case No. 2010-00036
Page 1 of 1
Revised

| Line No. | Description | Company Proposed (A) | AG Adjustments (B) | AG Proposed (C) |
|---|---|---|---|---|
| | **Plant in Service** | | | |
| 1 | Utility Plant in Service | $ 566,014,484 | $ - | $ 566,014,484 |
| 2 | Property Held for Future Use | $ - | $ - | $ - |
| 3 | Utility Plant Acquisition Adjustments | $ 2,342 | $ - | $ 2,342 |
| 4 | Accumulated Depreciation | $ (110,085,251) | $ 269,724 | $ (109,815,527) |
| 5 | **Net Utility Plant in Service** | $ 455,931,575 | $ 269,724 | $ 456,201,299 |
| 6 | Construction Work in Progress | $ 9,463,931 | $ (9,463,931) | $ - |
| 7 | Cash Working Capital | $ 2,634,000 | $ (980,000) | $ 1,654,000 |
| 8 | Other Working Capital Allowance | $ 642,421 | $ - | $ 642,421 |
| 9 | Contributions in Aid of Construction | $ (48,865,890) | $ - | $ (48,865,890) |
| 10 | Customer Advances | $ (19,089,182) | $ - | $ (19,089,182) |
| 11 | Accumulated Deferred Income Taxes | $ (40,026,731) | $ (2,480,026) | $ (42,506,757) |
| 12 | Accumulated Deferred Investment Tax Credit | $ (76,952) | $ - | $ (76,952) |
| 13 | Deferred Maintenance | $ 2,708,236 | $ (45,500) | $ 2,662,736 |
| 14 | Deferred Debits | $ 1,700,474 | $ (2,342) | $ 1,698,132 |
| 15 | Other Non-Investor Supplied Capital | $ (2,349,854) | $ - | $ (2,349,854) |
| 16 | | | $ - | $ - |
| 17 | | | $ - | $ - |
| 18 | | | $ - | $ - |
| 19 | **Rate Base** | $ 362,672,028 | $ (12,702,075) | $ 349,969,953 |

Notes and Source

Col.A: KAWC Exhibit 37, Schedule B-1
Col.B: Schedule B.1

Kentucky-American Water Company
Summary of Adjustments to Rate Base

Test Year Ended September 30, 2011

Exhibit RCS-1
Schedule B.1
Case No. 2010-00036
Page 1 of 1
Revised

| Line No. | Description | AG Adjustments | Construction Work in Progress B-1 | Acquisition Adjustment Double Count B-2 | Cash Working Capital B-3 | Labor Costs in Deferred Maintenance B-4 | Accumulated Depreciation B-5 | Accumulated Deferred Income Taxes - Deferred Maintenance B-6 | Accumulated Deferred Income Taxes - Major Tax Accounting Change B-7 |
|---|---|---|---|---|---|---|---|---|---|
| | **Plant in Service** | | | | | | | | |
| 1 | Utility Plant in Service | $ - | | | | | | | |
| 2 | Property Held for Future Use | $ - | | | | | | | |
| 3 | Utility Plant Acquisition Adjustments | $ - | | | | | | | |
| 4 | Accumulated Depreciation | $ 269,724 | | | | | $ 269,724 | | |
| 5 | **Net Utility Plant in Service** | $ 269,724 | $ - | $ - | $ - | $ - | $ 269,724 | $ - | $ - |
| 6 | Construction Work in Progress | $ (9,463,931) | $ (9,463,931) | | | | | | |
| 7 | Cash Working Capital | $ (980,000) | | | $ (980,000) | | | | |
| 8 | Other Working Capital Allowance | $ - | | | | | | | |
| 9 | Contributions in Aid of Construction | $ - | | | | | | | |
| 10 | Customer Advances | $ - | | | | | | | |
| 11 | Accumulated Deferred Income Taxes | $ (2,480,026) | | | | | $ (104,923) | $ 17,700 | $ (2,392,803) |
| 12 | Accumulated Deferred Investment Tax Credit | $ - | | | | | | | |
| 13 | Deferred Maintenance | $ (45,500) | | | | $ (45,500) | | | |
| 14 | Deferred Debits | $ (2,342) | | $ (2,342) | | | | | |
| 15 | Other Non-Investor Supplied Capital | $ - | | | | | | | |
| 16 | | $ - | | | | | | | |
| 17 | | $ - | | | | | | | |
| 18 | | $ - | | | | | | | |
| 19 | **Jurisdictional Rate Base** | $ (12,702,075) | $ (9,463,931) | $ (2,342) | $ (980,000) | $ (45,500) | $ 164,801 | $ 17,700 | $ (2,392,803) |

Notes and Source
See referenced schedule for each adjustment

Kentucky-American Water Company
Adjusted Net Operating Income

Test Year Ended September 30, 2011

Exhibit RCS-1
Schedule C
Case No. 2010-00036
Page 1 of 1
Revised

| Line No. | Description | Per Company | Per AG AG Adjustments | Per AG Per AG | Per AG Components of Revenue Change | Per AG Revenue Requirement Impact |
|---|---|---|---|---|---|---|
| | | (A) | (B) | (C) | (D) | (E) |
| | **Operating Revenue** | | | | | |
| 1 | Water Sales | $ 64,753,488 | $ - | $ 64,753,488 | $ 13,316,876 | $ 78,070,364 |
| 2 | Other Operating Revenues | $ 3,770,138 | $ (646,180) | $ 3,123,958 | | $ 3,123,958 |
| 3 | **Total Operating Revenues** | $ 68,523,626 | $ (646,180) | $ 67,877,446 | $ 13,316,876 | $ 81,194,322 |
| | **Operating Expenses** | | | $ - | | |
| 4 | Labor | $ 8,039,623 | $ (762,821) | $ 7,276,802 | | $ 7,276,802 |
| 5 | Purchased Water | $ 120,655 | $ - | $ 120,655 | | $ 120,655 |
| 6 | Fuel and Power | $ 4,375,584 | $ - | $ 4,375,584 | | $ 4,375,584 |
| 7 | Chemicals | $ 1,772,730 | $ - | $ 1,772,730 | | $ 1,772,730 |
| 8 | Waste Disposal | $ 340,226 | $ (12,376) | $ 327,850 | | $ 327,850 |
| 9 | Management Fees | $ 9,028,121 | $ (1,013,387) | $ 8,014,734 | | $ 8,014,734 |
| 10 | Group Insurance | $ 2,313,543 | $ (185,341) | $ 2,128,202 | | $ 2,128,202 |
| 11 | Pensions | $ 1,267,732 | $ (315,882) | $ 951,850 | | $ 951,850 |
| 12 | Regulatory Expense | $ 366,462 | $ (214,416) | $ 152,046 | | $ 152,046 |
| 13 | Insurance Other than Group | $ 742,262 | $ (3,757) | $ 738,505 | | $ 738,505 |
| 14 | Customer Accounting | $ 1,712,517 | $ (27,589) | $ 1,684,928 | $ 98,678 | $ 1,783,606 |
| 15 | Rents | $ 27,654 | $ - | $ 27,654 | | $ 27,654 |
| 16 | General Office Expense | $ 639,778 | $ - | $ 639,778 | | $ 639,778 |
| 17 | Miscellaneous | $ 3,440,139 | $ (25,070) | $ 3,415,069 | $ 21,547 | $ 3,436,616 |
| 18 | Maintenance Other | $ 1,272,341 | $ - | $ 1,272,341 | | $ 1,272,341 |
| 19 | Total O&M Expenses | $ 35,459,367 | $ (2,560,639) | $ 32,898,728 | $ 120,225 | $ 33,018,953 |
| 20 | Depreciation | $ 11,086,076 | $ (654,031) | $ 10,432,045 | | $ 10,432,045 |
| 21 | Amortization | $ 233,721 | $ - | $ 233,721 | | $ 233,721 |
| 22 | General Taxes: | | | $ - | | $ - |
| 23 | Property and Capital Stock | $ 4,429,174 | $ - | $ 4,429,174 | | $ 4,429,174 |
| 24 | Gross Receipts and Sales | $ 109,826 | $ - | $ 109,826 | | $ 109,826 |
| 25 | Payroll | $ 621,307 | $ (104,053) | $ 517,254 | | $ 517,254 |
| 26 | Miscellaneous | $ - | $ - | $ - | | $ - |
| 27 | **Operating Expenses Before Taxes** | $ 51,939,471 | $ (3,318,723) | $ 48,620,748 | $ 120,225 | $ 48,740,973 |
| 28 | Operating Income Before Income Taxes | $ 16,584,155 | $ 2,672,543 | $ 19,256,698 | $ 13,196,651 | $ 32,453,349 |
| 29 | **State and Federal Income Taxes** | | | | | |
| 30 | State Income Tax | | | | | |
| 31 | Current | $ (164,573) | $ 204,037 | $ 39,464 | $ 791,799 | $ 831,263 |
| 32 | Deferred | $ 318,502 | $ - | $ 318,502 | | $ 318,502 |
| 33 | Federal Income Tax | | | $ - | | $ - |
| 34 | Current | $ (902,408) | $ (242,819) | $ (1,145,227) | $ 4,341,698 | $ 3,196,471 |
| 35 | Deferred | $ 1,944,164 | $ - | $ 1,944,164 | | $ 1,944,164 |
| 36 | Deferred Investment Tax Credit | $ (84,797) | $ - | $ (84,797) | | $ (84,797) |
| 37 | **Total State and Federal Income Taxes** | $ 1,110,888 | $ (38,782) | $ 1,072,106 | $ 5,133,497 | $ 6,205,603 |
| 38 | | | | | | |
| 39 | **Total Operating Expenses** | $ 53,050,359 | $ (3,357,505) | $ 49,692,854 | $ 5,253,722 | $ 54,946,576 |
| 40 | **Net Operating Income** | **$ 15,473,267** | **$ 2,711,325** | **$ 18,184,592** | **$ 8,063,154** | **$ 26,247,746** |
| 41 | **Rate Base** | $ 362,672,028 | $ (12,702,075) | $ 349,969,953 | | $ 349,969,953 |
| 42 | **Earned Rate of Return** | 4.27% | | 5.20% | | 7.500% |

Notes and Source

Col.A: KAWC Exhibit 37, Schedule C-2
Col.B: Schedule C.1
Col.C: Col.A + Col.B
Col.D: Schedule A-1
Col.E: Col. C + Col. D

Kentucky-American Water Company
Summary of Net Operating Income Adjustment

Test Year Ended September 30, 2011



| Line No. | Description | AG Adjustments | Income Tax Expense Interest Synchronization | Income Tax Expense - Consolidated Tax Savings | Allowance for Funds Used During Construction | Incentive Compensation Expense | Stock-Based Compensation Expense | Affiliate Management Fees - Excess Over Current Budget | Affiliate Management Fees - Business Development Expense | Affiliate Management Fees - Donations and Miscellaneous Expenses | Pension and OPEB Expense Correction |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | C-1 Revised | C-2 | C-3 | C-4 | C-5 | C-6 | C-7 | C-8 | C-9 |
| | **Operating Revenue** | | | | | | | | | | |
| 1 | Water Sales | $ - | | | | | | | | | |
| 2 | Other Operating Revenues | $ (646,180) | | | $ (646,180) | | | | | | |
| 3 | **Total Operating Revenues** | $ (646,180) | $ - | $ - | $ (646,180) | $ - | $ - | $ - | $ - | $ - | $ - |
| | **Operating Expenses** | | | | | | | | | | |
| 4 | Labor | $ (762,821) | | | | $ (349,529) | $ (27,228) | | | | |
| 5 | Purchased Water | $ - | | | | | | | | | |
| 6 | Fuel and Power | $ - | | | | | | | | | |
| 7 | Chemicals | $ - | | | | | | | | | |
| 8 | Waste Disposal | $ (12,376) | | | | | | | | | |
| 9 | Management Fees | $ (1,013,387) | | | | $ (436,987) | $ (179,208) | $ (133,057) | $ (198,342) | $ (65,793) | |
| 10 | Group Insurance | $ (185,341) | | | | | | | | | $ (52,206) |
| 11 | Pensions | $ (315,882) | | | | | | | | | $ (253,262) |
| 12 | Regulatory Expense | $ (214,416) | | | | | | | | | |
| 13 | Insurance Other than Group | $ (3,757) | | | | | | | | | |
| 14 | Customer Accounting | $ (27,589) | | | | | | | | | |
| 15 | Rents | $ - | | | | | | | | | |
| 16 | General Office Expense | $ - | | | | | | | | | |
| 17 | Miscellaneous | $ (25,070) | | | | | | | | | |
| 18 | Maintenance Other | $ - | | | | | | | | | |
| 19 | Total O&M Expenses | $ (2,560,639) | $ - | $ - | $ - | $ (786,516) | $ (206,436) | $ (133,057) | $ (198,342) | $ (65,793) | $ (305,468) |
| 20 | Depreciation | $ (654,031) | | | | | | | | | |
| 21 | Amortization | $ - | | | | | | | | | |
| 22 | General Taxes: | | | | | | | | | | |
| 23 | Property and Capital Stock | $ - | | | | | | | | | |
| 24 | Gross Receipts and Sales | $ - | | | | | | | | | |
| 25 | Payroll | $ (104,053) | | | | | | | | | |
| 26 | Miscellaneous | $ - | | | | | | | | | |
| 27 | **Operating Expenses Before Taxes** | $ (3,318,723) | $ - | $ - | $ - | $ (786,516) | $ (206,436) | $ (133,057) | $ (198,342) | $ (65,793) | $ (305,468) |
| 28 | Operating Income Before Income Taxes | $ 2,672,543 | $ - | $ - | $ (646,180) | $ 786,516 | $ 206,436 | $ 133,057 | $ 198,342 | $ 65,793 | $ 305,468 |
| 29 | **State and Federal Income Taxes** | | | | | | | | | | |
| 30 | State Income Tax | | | | | | | | | | |
| 31 | Current | $ 204,037 | $ 43,685 | $ - | $ (38,771) | $ 47,191 | $ 12,386 | $ 7,983 | $ 11,901 | $ 3,948 | $ 18,328 |
| 32 | Deferred | $ - | | | | | | | | | |
| 33 | Federal Income Tax | | | | | | | | | | |
| 34 | Current | $ (242,819) | $ 239,537 | $ (1,361,624) | $ (212,593) | $ 258,764 | $ 67,918 | $ 43,776 | $ 65,254 | $ 21,646 | $ 100,499 |
| 35 | Deferred | $ - | | | | | | | | | |
| 36 | Deferred Investment Tax Credi | $ - | | | | | | | | | |
| 37 | **Total State and Federal Income Taxes** | $ (38,782) | $ 283,222 | $ (1,361,624) | $ (251,364) | $ 305,955 | $ 80,304 | $ 51,759 | $ 77,155 | $ 25,594 | $ 118,827 |
| 38 | | | | | | | | | | | |
| 39 | **Total Operating Expenses** | $ (3,357,505) | $ 283,222 | $ (1,361,624) | $ (251,364) | $ (480,561) | $ (126,132) | $ (81,298) | $ (121,187) | $ (40,199) | $ (186,641) |
| 40 | **Net Operating Income** | $ 2,711,325 | $ (283,222) | $ 1,361,624 | $ (394,816) | $ 480,561 | $ 126,132 | $ 81,298 | $ 121,187 | $ 40,199 | $ 186,641 |

Notes and Source

| | |
|---|---|
| Line 31 State Income Tax | 6.00% |
| Line 34 Federal Income Tax | 35.00% |

Kentucky-American Water Compan
Summary of Net Operating Income Adjustment

Test Year Ended September 30, 2011



| Line No. | Description | Rate Case Expense - Prior Rate Cases | Rate Case Expense - Current Rate Case | Depreciation Expense | Capitalization Rate | Employee Party, Outing and Gift Expenses | Vacancies and Over-projection of Pay Increases | KRS Lagoon Cleaning Expense Normalization | Uncollectibles Expense | Payroll Tax Expense |
|---|---|---|---|---|---|---|---|---|---|---|
| | | C-10 | C-11 | C-12 | C-13 | C-14 | C-15 | C-16 | C-17 | C-18 |
| | **Operating Revenue** | | | | | | | | | |
| 1 | Water Sales | | | | | | | | | |
| 2 | Other Operating Revenues | | | | | | | | | |
| 3 | **Total Operating Revenues** | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - |
| | **Operating Expenses** | | | | | | | | | |
| 4 | Labor | | | | $ (222,279) | | $ (163,785) | | | |
| 5 | Purchased Water | | | | | | | | | |
| 6 | Fuel and Power | | | | | | | | | |
| 7 | Chemicals | | | | | | | | | |
| 8 | Waste Disposal | | | | | | | $ (12,376) | | |
| 9 | Management Fees | | | | | | | | | |
| 10 | Group Insurance | | | | $ (75,777) | | $ (57,358) | | | |
| 11 | Pensions | | | | $ (36,840) | | $ (25,780) | | | |
| 12 | Regulatory Expense | $ (148,128) | $ (66,288) | | | | | | | |
| 13 | Insurance Other than Group | | | | $ (3,757) | | | | | |
| 14 | Customer Accounting | | | | | | | | $ (27,589) | |
| 15 | Rents | | | | | | | | | |
| 16 | General Office Expense | | | | | | | | | |
| 17 | Miscellaneous | | | | | $ (25,070) | | | | |
| 18 | Maintenance Other | | | | | | | | | |
| 19 | Total O&M Expenses | $ (148,128) | $ (66,288) | $ - | $ (338,653) | $ (25,070) | $ (246,923) | $ (12,376) | $ (27,589) | $ - |
| 20 | Depreciation | | | $ (654,031) | | | | | | |
| 21 | Amortization | | | | | | | | | |
| 22 | General Taxes: | | | | | | | | | |
| 23 | Property and Capital Stock | | | | | | | | | |
| 24 | Gross Receipts and Sales | | | | | | | | | |
| 25 | Payroll | | | | $ (19,898) | | | | | $ (84,155) |
| 26 | Miscellaneous | | | | | | | | | |
| 27 | **Operating Expenses Before Taxes** | $ (148,128) | $ (66,288) | $ (654,031) | $ (358,551) | $ (25,070) | $ (246,923) | $ (12,376) | $ (27,589) | $ (84,155) |
| 28 | Operating Income Before Income Taxe | $ 148,128 | $ 66,288 | $ 654,031 | $ 358,551 | $ 25,070 | $ 246,923 | $ 12,376 | $ 27,589 | $ 84,155 |
| 29 | **State and Federal Income Taxes** | | | | | | | | | |
| 30 | State Income Tax | | | | | | | | | |
| 31 | Current | $ 8,888 | $ 3,977 | $ 39,242 | $ 21,513 | $ 1,504 | $ 14,815 | $ 743 | $ 1,655 | $ 5,049 |
| 32 | Deferred | | | | | | | | | |
| 33 | Federal Income Tax | | | | | | | | | |
| 34 | Current | $ 48,734 | $ 21,809 | $ 215,176 | $ 117,963 | $ 8,248 | $ 81,238 | $ 4,072 | $ 9,077 | $ 27,687 |
| 35 | Deferred | | | | | | | | | |
| 36 | Deferred Investment Tax Credi | | | | | | | | | |
| 37 | **Total State and Federal Income Taxes** | $ 57,622 | $ 25,786 | $ 254,418 | $ 139,476 | $ 9,752 | $ 96,053 | $ 4,815 | $ 10,732 | $ 32,736 |
| 38 | | | | | | | | | | |
| 39 | **Total Operating Expenses** | $ (90,506) | $ (40,502) | $ (399,613) | $ (219,075) | $ (15,318) | $ (150,870) | $ (7,561) | $ (16,857) | $ (51,419) |
| 40 | **Net Operating Income** | $ 90,506 | $ 40,502 | $ 399,613 | $ 219,075 | $ 15,318 | $ 150,870 | $ 7,561 | $ 16,857 | $ 51,419 |

Notes and Source

| | |
|---|---|
| Line 31 State Income Tax | 6.00% |
| Line 34 Federal Income Tax | 35.00% |

Kentucky-American Water Company
Accumulated Deferred Income Taxes - Major Tax Accounting Change

Test Year Ended September 30, 2011

Exhibit RCS-1
Schedule B-7
Case No. 2010-00036
Page 1 of 1
Revised

| Line No. | Description | Per KAWC (A) | Per AG (B) | AG Adjustment (C) |
|---|---|---|---|---|
| | **Adjustment to Accumulated Deferred Income Taxes Related to Normalization of Capitalized Repairs Tax Deduction** | | | |
| 1 | Accumulated Deferred State Income Tax - Rate Base Deduction | $ 1,320,777 | $ 1,320,777 | |
| 2 | KAWC Claimed FIN 48 Offset | $ (347,971) | | |
| 3 | Accumulated Deferred State Income Tax - Rate Base Deduction | $ 972,806 | $ 1,320,777 | $ 347,971 |
| 4 | Accumulated Deferred Federal Income Tax | $ 6,020,119 | $ 6,020,119 | |
| 5 | KAWC Claimed FIN 48 Offset | $ (2,044,832) | | |
| 6 | Accumulated Deferred Federal Income Tax - Rate Base Deduction | $ 3,975,287 | $ 6,020,119 | $ 2,044,832 |
| 7 | Total Rate Base Deduction | $ 4,948,093 | $ 7,340,896 | $ 2,392,803 |
| 8 | Adjustment to Rate Base | | | $ (2,392,803) |

Notes and Source
KAWC 6-17-2010 email and attachments

Kentucky-American Water Company
Interest Synchronization

Test Year Ended September 30, 2011

Exhibit RCS-1
Schedule C-1
Case No. 2010-00036
Page 1 of 1
Revised

| Line No. | Description | Tax Rate | Per Company Amount (A) | Per AG Amount (B) | Reference |
|---|---|---|---|---|---|
| 1 | Adjusted Rate Base | | $ 362,672,028 | $ 349,969,953 | Schedule B |
| 2 | Weighted Cost of Debt | | 3.365% | 3.305% | Schedule D |
| 3 | Going-Level Interest Deduction for Tax Purposes | | $ 12,203,914 | $ 11,566,507 | L1 x L2 |
| 4 | Difference in Interest Deduction in KAW calculation | | $ 90,668 | | |
| 5 | Going-Level Interest Deduction per Company | | $ 12,294,582 | $ 12,294,582 | Note A |
| 6 | Decrease in Deductible Interest | | | $ (728,075) | L3 - L4 |
| 7 | State Income Taxes | 6.00% | | $ 43,685 | Schedule A-1 |
| 8 | Federal Taxable Income | | | $ (684,390) | L5 - L6 |
| 9 | Federal Income Taxes | 35.00% | | $ 239,537 | Schedule A-1 |
| 10 | Increase (Decrease) to Income Tax Expense | | | 283,222 | L6 + L8 |

Notes and Source

Note A: KAW's filing at Exhibit 37, Schedule E-1.3, page 1,line 15 and Schedule E-1.4, page 1, line 15

oag c exh 1

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

| | | |
|---|---|---|
| IN THE MATTER OF: | ) | |
| | ) | |
| NOTICE OF ADJUSTMENT OF THE RATES OF | ) | CASE NO. 2004-00103 |
| KENTUCKY AMERICAN WATER COMPANY | ) | |
| EFFECTIVE ON AND AFTER MAY 30, 2004 | ) | |

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# DIRECT TESTIMONY OF PATRICK BARYENBRUCH

April 30, 2004

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ATTY GEN. EXHIBIT 1

TESTIMONY OF
PATRICK L. BARYENBRUCH

FILED ON BEHALF OF
KENTUCKY-AMERICAN WATER COMPANY

1. Q. Please state your name and business address.

A. Patrick L. Baryenbruch, 302 East Park Drive, Raleigh, North Carolina 27605.

2. Q. Please describe your educational and professional background.

A. I received a Bachelors degree in accounting from the University of Wisconsin-Oshkosh in 1974 and a Masters in Business Administration degree from the University of Michigan in 1979.

I am a certified public accountant and am a member of the American Institute of Certified Public Accountants and the North Carolina Association of Certified Public Accountants.

I began my career as a staff accountant with Arthur Andersen & Company where I performed financial audits of utilities, banks and finance companies. After three years I left to pursue an M.B.A. degree. Upon graduation from business school, I worked with the consulting firms of Theodore Barry & Associates and Scott, Madden & Associates.

During my consulting career, I have performed consulting assignments for approximately 50 utilities and 10 public service commissions. I have participated as project manager, lead or staff consultant for 24 commission-ordered management and prudence audits of public utilities. Of these, I have been responsible for evaluating the area of affiliate charges and allocation of corporate expenses in the Commission-ordered audits of Connecticut Light and Power, Connecticut Natural Gas, General Water Corporation (Pennsylvania Operations), Philadelphia Suburban Water Company, Pacific Gas & Electric Company and Southern California Edison.

My firm has performed the commission-ordered audit of Southern California Edison's 2002 and 2003 transactions with its non-regulated affiliate companies.

3. Q. What are your duties and responsibilities in your current position?

A. I am the President of my own consulting practice, Baryenbruch & Company, which was established in 1985. In that capacity, I provide consulting services to utilities and their regulators.

4. Q. Please describe the reason for your testimony in this case.

A. I am presenting the results of my study which evaluated the services provided by American Water Service Company (Service Company) to Kentucky-American Water Company (Kentucky-American). This study was undertaken in conjunction with Kentucky-American's rate case and is true to the best of my knowledge and belief. The study is attached as Exhibit PLB-1.

5. Q. What were the objectives of your study?

A. This study was undertaken to answer three questions. First, what would be the economic impact on Kentucky-American if it were to outsource the managerial, professional and technical services that it now receives from American Water Service Company, Inc. (Service Company)? Second, are the costs of American Water's National Call Center reasonable? Third, are the services Kentucky-American receives from the Service Company necessary?

6. Q. What conclusions were you able to draw concerning question number 1, the economic impact of outsourcing all the services provided by the Service Company?

A. I was able to draw the following conclusions:

(1) On average, the hourly rates for outside service providers are more than 74% higher than the Service Company's hourly rates.

(2) The managerial, professional and technical services provided by the Service Company are vital and could not be procured externally by Kentucky-American without careful supervision on the part of Kentucky-American. If these services were contracted entirely to outside providers, Kentucky-American would have to add at least one more position to manage activities of the outside firms. This position would be essential to ensure a high level of quality service is being provided.

(3) If all the managerial, professional and technical services now provided by the Service Company had been out-sourced during the 12-months ended December 31, 2003, Kentucky-American and its ratepayers would have incurred an additional $2,333,931 in expenses. This amount includes the added cost of outside providers and the cost of one Kentucky-American position needed to direct this outsourced work. This is over 71% more than the Service Company's total billings to Kentucky-American during the year ended December 31, 2003.

(4) It would be difficult for Kentucky-American to find local service providers with the same specialized water industry expertise as that possessed by the Service Company staff. Service Company personnel spend substantially all their time serving operating water companies. This specialization brings with it a unique knowledge of water utility operations and regulation that is most likely unavailable from local service providers.

(5) Service Company fees do not include any profit markup. Only its actual cost of service is being recovered from Kentucky-American ratepayers.

7. Q. What is your conclusion regarding the reasonableness of the costs of American Water's National Call Center that provides service to Kentucky-American?

A. I was able to determine that the cost of the Service Company's customer accounts services, including those provided by the National Call Center, are less than the average of electric utilities in Kentucky and surrounding states. During the 12-months ended December 31, 2003, the annualized customer accounts cost for Kentucky-American customers was $24.38 compared to the 2002 average of $25.64 for neighboring electric utilities.

8. Q. What conclusions were you able to draw concerning the necessity of the services Kentucky-American receives from the Service Company?

A. I was able to draw the following conclusions:

(1) Kentucky-American could not function without the services that are provided to it by the Service Company. These services are the same type of activities that must be carried out by a stand-alone utility company to ultimately provide customers with service.

(2) There is no redundancy in the services provided by the Service Company and the activities that are performed by Kentucky-American itself.

9. Q. Does this complete your testimony?

A. Yes.

**KENTUCKY-AMERICAN WATER COMPANY**
**CASE NO. 2010-00036**
**ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION**

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**Witness: Patrick Baryenbruch**

85. Provide a complete copy of the contract and all invoices related to the work performed by Mr. Baryenbruch and his firm.

**Response:**

Attached is the contract and invoice for the work performed by Patrick Baryenbruch.

For the electronic version, refer to KAW_R_AGDR1#85_042610.pdf.

**Baryenbruch & Company, LLC**

Management Consultants

September 4, 2009

Michael A. Miller
Director of Rates and Regulation
American Water Works Service Company
P.O. Box 1906
Charleston, WV 25327

Dear Mike:

This is my proposal to perform a market comparison study for the cost of services provided by American Water Service Company, Inc. (AWSC) to Kentucky Water Company (KAWC) for 12 months ended September 30, 2009. My study will be used in connection with a Kentucky rate case for the 6 months ended November 30, 2009.

**Study Scope and Methodology**

I will follow the same approach I have successfully used in previous cost comparison studies for American Water and other utility clients. This study will answer the following questions:

1. Were the Service Company's charges to KAWC during the 12 months ended September 30, 2009 reasonable?

2. Was KAWC charged the lower of cost or market for managerial and professional services provided by the Service Company during 12 months ended September 30, 2009?

3. Were KAWC's 12 months ended September 30, 2009 charges from the Service Company for customer accounts services, including those provided by the National Call Centers, comparable to those of other utilities?

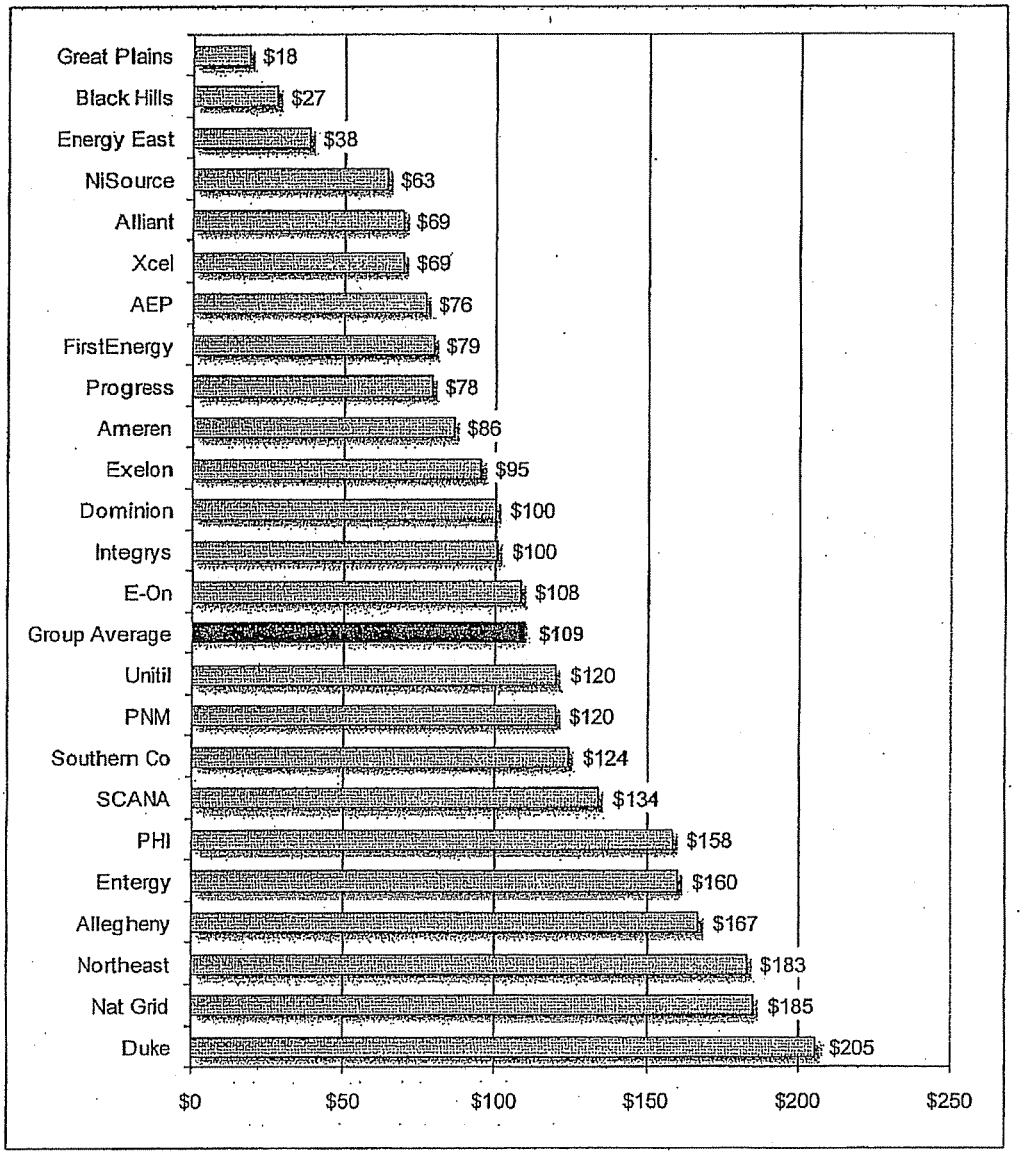
4. Are the services KAWC receives from Service Company necessary?

Reasonableness of AWSC's Charges

The reasonableness test will be based on KAWC's cost per customer for AWSC's 12 months ended September 30, 2009 charges compared to the cost per regulated customer for service companies that must file a Form 60 with Federal Energy Regulatory Commission (FERC). This report is designed to collect financial information from service companies that are subject to FERC's regulation. Approximately 30 service companies associated with 24 electric utilities filed a Form 60.

*2832 Claremont Road Raleigh, North Carolina 27608*
*patrickbaryenbruch.com Phone 919 832 3444 Fax 919 832 3488*

The end product of this analysis will be a cost per regulated customer comparison that supports the determination of reasonableness of AWSC's 12 months ended September 30, 2009 charges to KAWC. The graph below shows an example of this analysis from another study. This evaluation will be conducted using 2008 FERC data, the latest available service company information.



Lower of Cost or Market Evaluation

I will answer the second question by comparing AWSC's charges during the 12 months ended September 30, 2009 to the cost of procuring the same services from outside providers–attorneys, management consultants, accountants and engineers. This will be accomplished by converting AWSC's categorized charges into a cost per hour based on the test year dollars and hours charged to KAWC. AWSC's hourly rates are then compared to outside provider hourly billing rates.

Certain adjustments must be made to AWSC's actual charges to put its hourly rates on the same basis as outside provider hourly billing rates. For example, the table below shows the calculation of AWSC's 2007 hourly rates from my Virginia American study.

| | Attorney | Management Consultant | Certified Public Accountant | Professional Engineer | Total |
|---|---|---|---|---|---|
| Total management, professional & technical services charges | $ 79,237 | $ 928,973 | $ 1,020,240 | $ 446,476 | $ 2,474,926 |
| Less: | | | | | |
| Contract services | $ 1,027 | $ 22,660 | $ 47,621 | $ 16,842 | $ 88,150 |
| Travel expenses | $ 5,721 | $ 89,271 | $ 110,141 | $ 48,969 | $ 254,101 |
| Computer hardware/software | $ 0 | $ 12,915 | $ 26,698 | $ 1,880 | $ 41,493 |
| Net Service Charges (A) | $ 72,488 | $ 804,127 | $ 835,780 | $ 378,785 | $ 2,091,181 |
| Total Hours (B) | 372 | 5,573 | 12,770 | 5,684 | 24,399 |
| **Average Hourly Rate (A / B)** | $ 195 | $ 144 | $ 65 | $ 67 | |

Outside provider hourly rates will be obtained from the sources described below.

- **Certified Public Accountants** – The American Institute of Certified Public Accountants conducts a bi-annual survey of its members. I will obtain the Kentucky version of the 2008 survey which includes hourly billing rates for Kentucky CPA firms as of December 31, 2007. I will calculate an overall average hourly rate for Kentucky CPAs and escalate it for inflation to March 31, 2009, the mid-year point of 12 months ended September 30, 2009.

- **Management Consultants** – I will use the "Survey of Key Management Information, Operating Ratios for Management Consulting Firms" published by the Association of Management Consulting Firms, the industry's trade organization. I will utilize the 2009 survey, which contains 2008 hourly rate information. The survey includes average hourly billing rates for firms throughout the US. I feel it is appropriate to use national rather than a state data because management consultants do not limit their practice to any one region and typically travel to client locations. Using this survey data, I will calculate an overall average hourly rate for management consultants and escalate it for inflation to the March 31, 2009.

- **Attorneys** – It does not appear as though the Kentucky bar association surveys its members as to their hourly billing rates. Thus, I will have to estimate average Kentucky attorney billing rates using a surveys from Michigan Lawyers Weekly and Massachusetts Lawyers Weekly. The selected surveys' data will be adjusted for cost of living differences between the Michigan/Massachusetts law firms' cities and Lexington, Kentucky. The Lawyer's Weekly survey data will be as of December 31, 2007 and I will escalate the data for inflation to March 31, 2009.

- **Professional Engineers** – The association for professional civil engineers, the American Society of Civil Engineers, does not survey its members' billing rates. Neither does the National Society of Professional Engineers, the association for the entire engineering profession. Considering this lack of survey information, I have found the best way to obtain hourly billing rate information from engineering firms used in the past by KAWC or AWSC (for Kentucky work).

After compiling AWSC data and outsider provider data, I can then compare rates. Shown below is the comparison from my 2007 Virginia American study.

| | 12 Months Ended September 30, 2007 | | |
|---|---|---|---|
| Service Provider | Service Company | Outside Provider | Difference--Service Co. Greater(Less) Than Outside |
| Attorney | $ 195 | $ 276 | $ (82) |
| Management Consultant | $ 144 | $ 216 | $ (72) |
| Certified Public Accountant | $ 65 | $ 109 | $ (43) |
| Professional Engineer | $ 67 | $ 92 | $ (26) |

Finally, I will calculate the net cost/savings to KAWC associated with using AWSC rather than outside providers. Using the hourly rate differences and the number of hours billed by the AWSC during the test year, the total dollar impact will be calculated. The table below shows this calculation from my 2007 Virginia American study.

| | 12 Months Ended September 30, 2007 | | |
|---|---|---|---|
| Service Provider | Hourly Rate Difference--Service Co. Greater(Less) Than Outside | Service Company Hours Charged | Dollar Difference |
| Attorney | $ (82) | 372 | $ (30,356) |
| Management Consultant | $ (72) | 5,573 | $ (400,089) |
| Certified Public Accountant | $ (43) | 12,770 | $ (551,278) |
| Professional Engineer | $ (26) | 5,684 | $ (145,346) |
| Service Company Less Than Outside Providers | | | $ (1,127,069) |

Reasonableness of American Water's National Call Center Costs

The third issue—reasonableness of the National Call Center's costs—will be addressed by comparing KAWC's customer accounts expenses to those of Kentucky and neighboring electric utilities. It is difficult to compare the cost of American Water's National Call Center with outside providers of the same call center-related services. Call center survey data is proprietary and expensive to obtain.

Thus, I will utilize the next best cost comparison approach. KAWC's National Call Center charges for 12 months ended September 30, 2009 will be compared to customer accounts expenses of Kentucky and neighboring electric utilities because their data is publicly available from the 2008 FERC Form 1. The table below shows the end result of this comparison from my 2006 KAWC study. In this case, the National Call Center's cost per customer was very close to the group average.

| Average Customer Accounts Expense Per Customer | | |
|---|---|---|
| Louisville Gas & Electric | $ | 12.43 |
| Illinois Power | $ | 14.01 |
| Virginia Electric Power | $ | 15.77 |
| Ohio Edison | $ | 16.68 |
| Cleveland Electric Illuminating | $ | 17.15 |
| Dayton Power & Light | $ | 19.72 |
| Toledo Edison | $ | 21.45 |
| Indianapolis Power & Light | $ | 21.91 |
| Kentucky Utilities | $ | 24.87 |
| Union Heat, Light & Power | $ | 25.64 |
| Public Service of Indiana | $ | 26.02 |
| **Comparison Group Average** | **$** | **26.07** |
| Kansas City Power & Light | $ | 26.64 |
| **Kentucky American Water** | **$** | **26.98** |
| Wheeling Power | $ | 29.20 |
| Cincinnati Gas & Electric | $ | 30.50 |
| MidAmerican Energy | $ | 31.14 |
| Indiana Michigan Power | $ | 31.50 |
| Kingsport Power | $ | 32.18 |
| Ohio Power | $ | 32.30 |
| Appalachian Power | $ | 32.40 |
| Commonwealth Edison | $ | 33.43 |
| Kentucky Power | $ | 34.25 |
| Columbus & Souther Power | $ | 35.49 |
| Northern Indiana Public Serice | $ | 35.82 |

Need for AWSC's Services

The fourth issue—the need for AWSC services—will be addressed by identifying and evaluating specifically what the AWSC does for KAWC. Based on discussions with AWSC personnel, a matrix will be created showing which AWSC entities/locations are responsible for each of the functions KAWC requires to ultimately provide service to its customers. The matrix will be reviewed to determine: (1) if there was redundancy or overlap in the services being provided by the AWSC and (2) if AWSC services are typical of those needed by a stand-alone water utility. Shown below is page 1 of Exhibit 10 in my 2007 Virginia American report is an example of the matrix that will be developed for the KAWC study.

Exhibit Witness FLB-15
Schedule 10
Page 1 of 38

Virginia American Water Company
Designation Of Responsibility For Water Utility Functions

| Water Company Function | VAWC | Performed by: American Water Service Company: Customer Call Center | Regional Offices | Shared Services | Corporate Office | IT Service Center | Salerno Lab |
|---|---|---|---|---|---|---|---|
| Engineering and Construction Management | | | | | | | |
| CPS Preparation | | | | | | | |
| Five Year System Planning | | | | | | | |
| Engineering Standards & Policies Development | | | | | | | |
| Project Design | | | | | | | |
| Major Projects (e.g. new treatment plants) | | | | | | | |
| Special Projects | | | | | | | |
| Minor Projects (e.g., pipelines) | | | | | | | |
| Construction Project Management | | | | | | | |
| Major Projects | | | | | | | |
| Special Projects | | | | | | | |
| Minor Projects | | | | | | | |
| Hydraulic Reviews | | | | | | | |
| Developers Extensions | | | | | | | |
| Tank Painting | | | | | | | |
| Water Quality and Purification | | | | | | | |
| Water Quality Standards Development | | | | | | | |
| Research Studies | | | | | | | |
| Water Quality Program Implementation | | | | | | | |
| Water Treatment Operations & Maintenance | | | | | | | |
| Compliance Tracking and Chemical Testing | | | | | | | |
| Sample Collection and Other Testing | | | | | | | |
| Transmission and Distribution | | | | | | | |
| Preventive Maintenance Program Development | | | | | | | |
| System Maintenance | | | | | | | |
| Leak Detection | | | | | | | |
| Customer Service | | | | | | | |
| Community Relations | | | | | | | |
| Customer Contacts | | | | | | | |
| Call Processing | | | | | | | |
| Service Order Creation | | | | | | | |
| Service Order Processing | | | | | | | |
| Customer Orders | | | | | | | |
| Meter Reading | | | | | | | |
| Customer Bill Preparation | | | | | | | |
| Bill Collection | | | | | | | |
| Customer Payment Processing | | | | | | | |
| Meter Standards Development | | | | | | | |
| Meter Testing, Maintenance & Replacement | | | | | | | |

**End Product**

This study will culminate in a written report that documents my conclusions on the four questions concerning AWSC services to KAWC (reasonableness of AWSC's charges, lower of cost-or-market pricing, reasonableness of National Call Center charges and necessity of AWSC services). The report will include all supporting information necessary to substantiate my conclusions. I will also develop testimony that summarizes my report and the conclusions I was able to reach. A draft will be finished by December 15, 2009 and a final version will be completed by December 31, 2009.

**Patrick Baryenbruch's Previous Experience**

I have performed this same market cost comparison study for the clients listed below. Most of these engagements were carried out in conjunction with a rate case proceeding where I was the expert witness supporting a regulated operating utility's charges from an affiliated service company.

- American Water of Virginia – 1994, 1996, 1999, 2000, 2001, 2003, 2006, 2007
- American Water of Connecticut – 1999
- Illinois American Water Company – 2007
- American Water of Kentucky – 2003, 2006, 2008
- Long Island American Water – 2006
- American Water of Massachusetts – 2000
- American Water of Missouri – 2002
- American Water of New Jersey – 2005, 2007
- American Water of New Mexico – 2008
- American Water of Ohio – 2006

- American Water of Pennsylvania – 2008
- American Water of Tennessee – 1996, 2002, 2006
- American Water of West Virginia – 2002, 2006, 2007
- Atmos Energy Corporation (Virginia) – 2004
- Bay State Gas Company (Massachusetts) – 2004
- Columbia Gas of Virginia – 2003, 2004, 2005, 2006
- Duke Energy – 2006
- General Water Works/Rio Rancho Utilities (New Mexico) – 1993
- Roanoke Gas Company – 2006
- Virginia Natural Gas Company (AGL Resources, Inc.) – 2003, 2005
- United Water of Pennsylvania – 2004
- Utilities, Inc. (Virginia) – 2006

Besides these market cost comparison studies, my firm has performed the annual affiliate transaction audits of Southern California Edison (SCE) for the years 2002 through 2005. The objective of these evaluations is to express an opinion on the extent to which SCE was in compliance with the California Public Utilities Commission's extensive affiliate transaction rules. In addition to these studies and third party audits, I provide utility clients with on-going affiliate transaction-related advice and counsel in connection with their dealings with their regulators.

Exhibit 1 presents a more complete description of my utility-affiliate transactions experience.

**Cost Estimate**

Based on the scope of work outlined above, I estimate this study will cost $27,745 to complete. A breakdown of the hours and dollars is detailed in the table below.

| | | |
|---|---|---|
| Hours/Fees | | |
| 1. Determine the reasonableness of AWSC charges | | 25 |
| 2. Perform AWSC/outside provider cost comparison (LCM analysis) | | 40 |
| 3. Perform customer account services cost comparison | | 20 |
| 4. Assess KAWC's need for AWSC's services | | 2 |
| 5. Prepare Report | | 30 |
| | Total Hours | 117 |
| | Hourly Rate | $ 235 |
| Total Fees | | $ 27,495 |
| Expenses | | $ 250 |
| **Total Fees and Expenses** | | **$ 27,745** |

I am willing to undertake this study on a fixed price basis, with a not-to-exceed total for fees and expenses of $27,700. If the study does not take as much time as estimated to complete, you will only be billed for the actual costs incurred.

This budget does not include the cost of answering any potential rate case interrogatories or cross-examination. Should that be necessary, I will perform that work at an hourly rate of $235. If travel is required, that will be charged at actual cost.

I submit invoices monthly and include a timesheet and copies of expenses to back up all charges. With each invoice I will provide a budget status so you can monitor the completion of work against amounts billed.

I want to thank you for asking me to help on this important assignment. You can be assured I will give it my utmost attention.

Sincerely,

Patrick L. Baryenbruch
attachment

**Resume of Patrick L. Baryenbruch**

**Summary**

Mr. Baryenbruch began his consulting career in the late 1970s. He established his own practice in 1985 and has focused on providing services to utilities and their regulators. Mr. Baryenbruch has performed consulting assignments for over 50 utilities and 10 public service commissions.

Over the course of his career, Mr. Baryenbruch has served as an expert witness for many utility rate cases. In most instances, he was a witness for a utility client's position on some aspect of affiliate transactions.

He has participated as project manager, lead or staff consultant for over 20 commission-ordered management and prudence audits of public utilities. Of these, he has been responsible for evaluating the area of affiliate transactions and allocation of corporate expenses in the Commission-ordered audits of Connecticut Light and Power, Connecticut Natural Gas, General Waterworks Corporation (Pennsylvania Operations), Philadelphia Suburban Water Company. For the California Public Utilities Commission, Mr. Baryenbruch worked on the consultant team that performed the affiliate transactions audit of Pacific Gas & Electric (1990) and Southern California Edison (1991). Baryenbruch & Company conducted the annual audits of Southern California Edison's transactions with its unregulated affiliates for 2002 through 2005.

**Professional Credentials and Education**

Mr. Baryenbruch is a certified public accountant and is a member of the American Institute of Certified Public Accountants and the North Carolina Association of Certified Public Accountants. He holds a BBA in accounting from the University of Wisconsin-Oshkosh, where he graduated with high honors, and an MBA from the University of Michigan.

Employment

| | |
|---|---|
| 1985 to Present | Baryenbruch & Company, President |
| 1983 to 1985 | Scott, Madden & Associates, Managing Associate |
| 1979 to 1983 | Theodore Barry & Associates, Managing Associate |
| 1974 to 1977 | Arthur Andersen & Company, Staff Auditor |

Partial List of Clients

| | |
|---|---|
| AGL Resources, Inc. | Mississippi Power & Light Company |
| Allegheny Energy, Inc | Municipal Electric Authority of Georgia |
| American Water Company | Niagara Mohawk Power Corporation |
| Atlantic Electric Company | NiSource Inc./Columbia Gas |
| Atmos Energy Corporation | Orange & Rockland Utilities Company |
| BB&T Financial Corporation | Pacific Gas & Electric Company |
| Big Rivers Electric Corporation | Pennsylvania Power Company |
| British Columbia Hydro and Power Authority | Peoples Gas Light Company |
| Carolina Power & Light Company | Philadelphia Electric Company |
| Choptank Electric Cooperative | Philadelphia Gas Works |
| Chugach Electric Cooperative | Philadelphia Suburban Water Company |
| Cincinnati Milacron Company | Progress Energy, Inc. |
| City of Los Angeles Department of Water and Power | Public Service Electric & Gas Company |
| City Utilities of Springfield, Missouri | Rio Rancho Water Company |
| Commonwealth Edison Company | Roanoke Gas Company |
| Connecticut Light & Power Company | Rochester Gas & Electric Corporation |
| Connecticut Natural Gas Company | Rockland Electric Company |
| Consumers Power Company | Southern California Edison Company |
| Delta Natural Gas Company | System Energy Resources, Inc. |
| Duke Energy Corporation | Tennessee Valley Authority |
| Dominion Resources, Inc. | Texas Utilities Electric Company |
| ENASA/Pegaso Truck Company | Toledo Edison Company |
| Entergy Corporation | Trans Alaska Pipeline System |
| General Telephone Company | Tucson Electric Power Company |
| General Water Works Corporation | United Telephone Company |
| Houston Lighting and Power Company | United Water, Inc. |
| Iowa Power & Light Company | Utilities, Inc. |
| Kentucky Utilities Company | Wisconsin Gas Company |
| Madison Gas & Electric Company | Xomox Corporation |

**Resume of Patrick L. Baryenbruch**

**Representative Consulting Engagements**

- *Southern California Edison (SCE)* – Baryenbruch & Company conducted the audit of this utility's 2002, 2003, 2004 and 2005 transactions with its unregulated affiliates. The objective of this evaluation was to express an opinion on the extent to which SCE was in compliance with the California Public Utilities Commission's affiliate transaction rules. Baryenbruch & Company is also conducting the 2005 transaction audit.

- *American Water* – Mr. Baryenbruch has acted as an expert witness on the issue of service company charges in 23 rate cases. American Water has more than 3 million customers throughout the US. Its service company provides governance, executive management, legal, accounting, financial, human resources, engineering, operations support, water quality, information technology, and other critical services to operating companies in 18 states. Charges from the service company, which is located in New Jersey, are a contentious issue with some states. As their expert witness, Mr. Baryenbruch performs a study that determines if service company charges are at the lower of cost or market and whether these services are necessary. Mr. Baryenbruch has a perfect record as an expert witness for American Water. In every case in which he was the expert witness supporting service company charges, the operating company received full recovery of those charges.

  Mr. Baryenbruch has also helped prepare American Water staff for a management audit ordered by the state public utility commission in one state in which it does business.

- *Progress Energy* – In 2001, Mr. Baryenbruch evaluated Progress Energy's Service Company arrangement to ensure it complied with the North Carolina Public Utilities Commission's code of conduct for affiliate transactions. Through extensive interviews and data gathering, he was able to conclude that the service company arrangement: (1) is equitable in allocating expenses to the Progress Energy affiliates, (2) does not result in ratepayers subsidizing non-regulated businesses, and (3) is substantially in compliance with various regulatory commitments. His report was later filed in rate cases in Florida and North Carolina.

- *Duke Energy* – Mr. Baryenbruch is currently involved with Duke's enterprise-wide re-engineering of its accounting function and its merger with Cinergy Corporation. He has helped manage the upgrade of Duke's general ledger and finance information hub, projects that involved teams of over 100 Duke and consultant personnel. During 2004, Mr. Baryenbruch helped Duke manage the implementation of Sarbanes-Oxley 404. This project involved hundreds of Duke and contractor personnel, whose work had to be coordinated in order to finish on time. Mr. Baryenbruch is currently assisting Duke with its merger with Cinergy.

  Mr. Baryenbruch has also provided consulting assistance to Duke Energy's IT group, which has a staff of over 2,000 serving Duke's various regulated and non-regulated business units throughout the world. Among other things, he implemented a cost recovery process, which entailed developing a set of products, establishing cost pools, estimating unit usage and creating unit rates. IT's charges to internal customers are based on their unit usage of various products. This cost recovery arrangement was subjected to an audit by an outside CPA firm hired by the North Carolina Public Utility Commissions. That firm found it to be in compliance with the state's code of conduct rules.

  Also for Duke's IT group, Mr. Baryenbruch developed a performance measurement process that includes benchmarking and metrics relevant to internal customers. The focal point of this information is the enterprise IT scorecard which shows the performance of the central IT group and several business unit IT groups. The scorecard is presented to the senior management IT governance committee twice annually.

**Resume of Patrick L. Baryenbruch**

- *Entergy's Nuclear Operations Business Unit* – Mr. Baryenbruch designed a performance-based incentive rate proposal for the River Bend Nuclear Plant, which was acquired by Entergy when they purchased Gulf States Utilities during the mid-1990s. The proposed rate would have provided Entergy with additional revenues in return for capacity factor improvements and operating cost reductions.

  For Entergy Nuclear, Mr. Baryenbruch implemented an activity-based budgeting system for the Grand Gulf Nuclear Plant. He devised the budget concepts, developed the new budget system, conducted training for plant management and staff, and oversaw the preparation of the first activity-based budget.

  Also for Entergy Nuclear Mr. Baryenbruch developed an improved economic evaluation process for nuclear plant modification projects. The end-product of this assignment was a process for classifying projects, conducting a net present value analysis and force-ranking projects to facilitate management selection.

- *Commission-Order Audits* – Mr. Baryenbruch has participated in the following commission-ordered audits of utilities:

  - Atlantic Electric Company (management audit)
  - Choptank Electric Cooperative (management audit)
  - Chugach Electric Cooperative (management audit)
  - City Utilities of Springfield, Missouri (management audit)
  - City of Los Angeles Department of Water and Power (management audit)
  - Commonwealth Edison Company (management audit)
  - Connecticut Light & Power Company (management audit)
  - General Telephone Company (management audit)
  - General Water Works Corporation (management audit)
  - Kentucky Utilities Company (management audit)
  - Niagara Mohawk Power Corporation (management audit)
  - Pacific Gas & Electric Company (affiliate transactions audit)
  - Pennsylvania Power Company (management audit)
  - Peoples Gas Light Company (management audit)
  - Philadelphia Electric Company (nuclear plant prudence audit)
  - Philadelphia Gas Works (management audit)
  - Philadelphia Suburban Water Company (management audit)
  - Public Service Electric & Gas Company (management audit)
  - Rochester Gas & Electric Corporation (management audit)
  - Rockland Electric Company (management audit)
  - Southern California Edison Company (affiliate transactions audit)
  - United Telephone Company (management audit).

- *Carolina Power & Light* (operating company of Progress Energy) – Mr. Baryenbruch help implement a new budget system and related processes at the Company's three nuclear plants and in the corporate Nuclear staff organization. He later designed and implemented monthly budget variance reports for the Nuclear Generation Group's management team. He also designed and implemented a weekly outage reporting system for each nuclear plant to track the budget and schedule status of outage projects.

  For Carolina Power & Light's IT group, Mr. Baryenbruch assisted in development of a process management approach and designed a customer service/marketing program that featured customer research, market segmentation, product and service performance monitoring and customer satisfaction measurement.

**Resume of Patrick L. Baryenbruch**

- *Texas Utilities* – Mr. Baryenbruch served as a lead consultant in Metzler & Associate's prudence preparation engagement for the Comanche Peak Steam Electric Station. In this role, he supported the company's planning, training, and preparation of responses to retrospective audit inquiries.

- *Tennessee Valley Authority* – Mr. Baryenbruch was engaged by TVA to perform several consulting assignments. He evaluated the budgeting and variance reporting program for the Nuclear Generation Group. He assessed the inventory management program for the Generation and Customer Groups. He also determined the feasibility of bar code technology for managing the inventory of a large distribution facility. This projected developed a new receiving, storing, staging and issuance process to accompany the new bar code environment. Vendors were evaluated and the top five finalists sent requests for bid.

**Baryenbruch & Company, LLC**

Management Consultants



ADV
1400438S
INV 012910
A28UP02
AMT 26085.00

January 29, 2010

Kentucky American Water Company
Attn: Mr. Michael Miller
P.O. Box 5610
Cherry Hill, New Jersey 08034

2009 Service Company Market Cost Comparison Study

September 2009 - December 2009

| | Hours | Rate | Amount |
|---|---|---|---|
| Fees | | | |
| Sep-09 | 14.0 | | |
| Oct-09 | 21.5 | | |
| Nov-09 | 59.5 | | |
| Dec-09 | 16.0 | | |
| Total Hours/Fees | 111.0 | $235 | $26,085 |
| Expenses | | | |
| Total Invoice | | | $26,085 |

Note: Not-to-exceed budget is: $27,700

Terms: net 30

2832 Claremont Road Raleigh, North Carolina 27608
patrickbaryenbruch.com Phone 919 832 3444 Fax 919 832 3488

P.Baryenbruch
Kentucky American Water Company
2009 Market Cost Study

| | | | | | | | | | | | | | | | | TOTAL HOURS |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| September 2009 | DATE | 18 | 19 | 20 | 26 | | | | | | | | | | | |
| | [redacted] | 2.0 | 2.5 | 4.0 | 5.5 | | | | | | | | | | | 14.0 |
| October 2009 | DATE | 16 | 17 | 24 | 25 | 30 | 31 | | | | | | | | | |
| | [redacted] | 4.0 | 2.0 | 4.0 | 8.0 | 2.0 | 1.5 | | | | | | | | | 21.5 |
| November 2009 | DATE | 5 | 6 | 7 | 8 | 13 | 14 | 15 | 20 | 21 | 22 | 23 | 24 | 25 | | |
| | [redacted] | 2.0 | 4.5 | 5.0 | 2.0 | 4.0 | 2.0 | 4.0 | 8.0 | 10.0 | 6.0 | 4.0 | 4.0 | 4.0 | | 59.5 |
| December 2009 | DATE | 15 | 16 | 17 | 18 | | | | | | | | | | | |
| | [redacted] | 3.0 | 4.0 | 3.0 | 6.0 | | | | | | | | | | | 16.0 |
| January 2010 | [redacted] | | | | | | | | | | | | | | | |

Org c exh 3

# American Water Works Company, Inc. (AWK)

1025 LAUREL OAK ROAD
VOORHEES, NJ, 08043
856-346-8200
www.amwater.com

## 10-K

Annual report pursuant to section 13 and 15(d)
Filed on 3/1/2010
Filed Period 12/31/2009



ATTY GEN. EXHIBIT 3

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION
**Washington, D.C. 20549**

# FORM 10-K

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the fiscal year ended December 31, 2009**

**OR**

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the transition period from _____ to _____**

**Commission file: number 001-34028**

# AMERICAN WATER WORKS COMPANY, INC.
**(Exact name of registrant as specified in its charter)**

| **Delaware** | **51-0063696** |
|---|---|
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification No.)** |
| **1025 Laurel Oak Road, Voorhees, NJ** | **08043** |
| **(Address of principal executive offices)** | **(Zip Code)** |

**(856) 346-8200**
**(Registrant's telephone number, including area code)**

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Name of each exchange on which registered |
|---|---|
| Common stock, par value $0.01 per share | New York Stock Exchange, Inc. |

Securities registered pursuant to Section 12(g) of the Act: None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☑ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☑

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☑ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "small reporting company" in Rule 12(b)-2 of the Exchange Act.:

Large accelerated filer ☑ Accelerated filer ☐ Non-accelerated filer ☐ Small reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☑

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter.

Common Stock, $0.01 par value—$3,335,885,725 as of June 30, 2009.

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of the latest practicable date.

Common Stock, $0.01 par value per share—174,670,026 shares, as of February 25, 2010.

**DOCUMENTS INCORPORATED BY REFERENCE**

(1) Portions of the Company's Proxy Statement for the Company's 2010 Annual Meeting of Stockholders are incorporated by reference into Part III of this report.

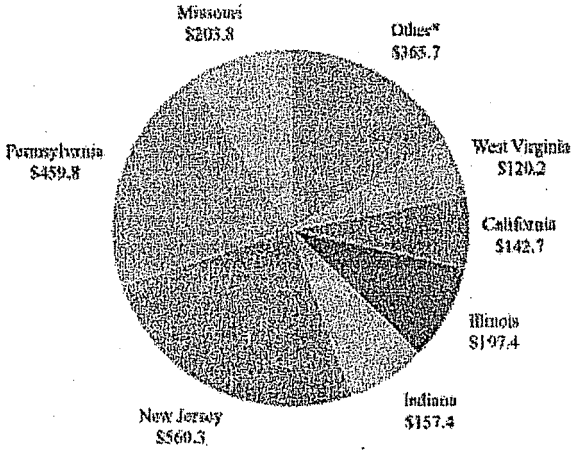
investment in our common stock through public offerings of an additional 15.4 million shares and 40.3 million shares, respectively. On November 24, 2009, RWE completed the sale in a public offering of the remaining 41.1 million shares of our common stock, including 3.7 million shares sold upon underwriters' exercise of their over-allotment option. As a result of the full exercise of the underwriter's option, RWE fully divested of our common stock.

*Regulated Businesses Overview*

Our primary business involves the ownership of water and wastewater utilities that provide water and wastewater services to residential, commercial and industrial customers. Our subsidiaries that provide these services are generally subject to economic regulation by certain state commissions or other entities engaged in economic regulation, hereafter referred to as "PUCs" in the states in which they operate. The federal government and the states also regulate environmental, health and safety, and water quality matters. We report the results of this business in our Regulated Businesses segment. For 2009, operating revenue for our Regulated Businesses was $2,207.3 million prior to inter-segment eliminations, accounting for 90.4% of total operating revenue for the same period. Regulated Business operating revenues were $2,082.7 million for 2008 and $1,987.6 million for 2007 accounting for 89.1% and 89.8% respectively, of total operating revenues for the same periods.

The following charts set forth operating revenue for 2009 and customers as of December 31, 2009, for the states in which our Regulated Businesses provide services:

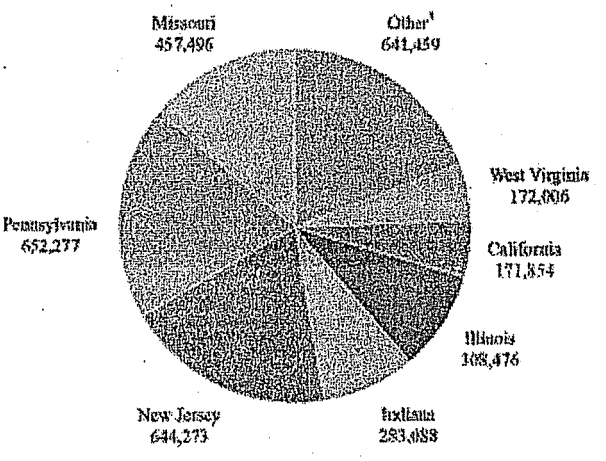
**Regulated Businesses Operating Revenue (dollars in millions)**




Total = $2,207.3

* Includes the combined results of our operating subsidiaries in the following states: Arizona, Georgia, Hawaii, Iowa, Kentucky, Maryland, Michigan, New Mexico, New York, Ohio, Tennessee, Texas and Virginia

**Regulated Businesses Customers**




Total = 3,330,929

† Includes data from our operating subsidiaries in the following states: Arizona, Georgia, Hawaii, Iowa, Kentucky, Maryland, Michigan, New Mexico, New York, Ohio, Tennessee, Texas and Virginia

*Non-Regulated Businesses Overview*

We also provide services that are not subject to economic regulation by state PUCs through our Non-Regulated Businesses. Our Non-Regulated Businesses include our:

- Contract Operations Group, which enters into public/private partnerships, including Operations and Maintenance, which we refer to as O&M contracts, and Design, Build and Operate, which we refer to as DBO contracts for the provision of services to water and wastewater facilities for municipalities, the

**Economic Regulation**

Our subsidiaries in the states in which we operate our Regulated Businesses are generally subject to extensive economic regulation by their respective state PUCs. The term "economic regulation" is intended to indicate that these state PUCs regulate the economic aspects of service to the public from systems that fall within their jurisdiction, but do not generally establish water quality standards, that are set by the EPA and/or state environmental authorities and enforced through state environmental or health agencies. State PUCs have broad authority (derived from state laws and state constitutions under which they operate) to regulate many of the economic aspects of the utilities that fall within their jurisdiction. For example, state PUCs issue certificates of public convenience and necessity (or similar authorizations) that may be required for a company to provide public utility services in specific areas of the state. They also must approve the rates and conditions under which service is provided to customers and have extensive authority to establish rules and regulations under which the utilities operate. Although specific authority might differ from state to state, in most states, these state PUCs must approve rates, accounting treatments, long–term financing programs, significant capital expenditures and plant additions, transactions between the regulated subsidiary and affiliated entities, reorganizations and mergers and acquisitions, in many instances prior to their completion. The jurisdiction exercised by each state PUC is prescribed by state laws and regulations and therefore varies from state to state. Regulatory policies not only vary from state to state, they may change over time. These policies will affect the timing as well as the extent of recovery of expenses and the realized return on invested capital.

Economic regulation of utilities deals with many competing, and occasionally conflicting, public interests and policy goals. The primary responsibility of state PUCs is to achieve the overall public interest by balancing the interests of customers and the utility and its stockholders. Although the specific approach to economic regulation does vary, certain general principles are consistent across the states in which our regulated subsidiaries operate. Based on the United States Constitution and state constitutions that prohibit confiscation of property without due process of law and just compensation, as well as state statutory provisions and court precedent, utilities are entitled to recover, through rates charged to customers, prudent and reasonable operating costs as well as an opportunity to earn an appropriate return on and recovery of our prudent, used and useful capital investment necessary to provide service to customers. The state PUCs will also generally accord a utility the right to serve specific areas and will also provide investor–owned utilities with limited protection from competition because the requirement of an investor–owned utility to operate pursuant to a certificate of public convenience and necessity (or similar authorizations) typically prevents other investor–owned utilities from competing with it in the authorized area. In return, the utility undertakes to provide reliable service on a nondiscriminatory basis to all customers within the authorized area.

Our operating revenue is typically determined by reference to a volumetric charge based on consumption and a base fee component set by a tariff approved by the relevant state PUC. Certain states have utilized a full or partial single rate policy, under which all customers in a state or certain regions within a state are charged utilizing a single rate structure, regardless of which of our individual systems serves them. The single tariff structure is based on costs that are determined on a state–wide or intra–state regional basis, thereby moderating the impact of periodic fluctuations in local costs while lowering administrative costs for us and our customers.

The process to obtain approval for a change in rates involves filing a petition or rate case with the state PUC on a periodic basis as determined by our capital expenditures needs and our operating costs. Rate cases are normally initiated by the regulated utility whenever the utility determines it needs to recover increased operating expenses or a return on new capital investment, or otherwise determines that its current authorized return is not sufficient, given current market conditions, to provide a reasonable return on investment. Typically a rate case will not be filed, however, unless the current or expected future return is below the allowed rate of return currently authorized by the regulator. A state PUC may also initiate a rate proceeding or investigation if it believes a utility may be earning in excess of its authorized rate of return. Rate cases often involve a lengthy and

costly administrative process. The utility, the state PUC staff, consumer advocates, and any other interveners who may participate in the process, prepare and file evidence, consisting of supporting testimony and documentation. This is presented in public hearings in connection with the rate case. These hearings, which are economic and service quality fact–finding in nature, are typically conducted in a trial–like setting before the state PUC or an administrative law judge. During the process, the utility is required to provide staff and interveners with all relevant information they may request concerning the utility's operations, expenses and investments. The sworn evidentiary record then forms the basis for a state PUC decision.

Some state PUCs are more restrictive than others with regard to the types of expenses and investments that may be recovered in rates as well as with regard to the transparency of their rate–making processes and how they reach their final rate determinations. However, in evaluating a rate case, state PUCs typically focus on five areas:

- the amount and prudence of investment in facilities considered "used and useful" in providing public service;
- the operating and maintenance costs and taxes associated with providing the service (typically by making reference to a representative 12–month period of time, known as a test year);
- the appropriate rate of return;
- the tariff or rate design that allocates revenue requirements equitably among the customer classes; and
- the quality of service the utility provides, including issues raised by customers.

The decisions of state PUCs and the timing of those decisions can have a significant impact on the operations and earnings of our Regulated Businesses. Rate cases and other rate–related proceedings can take several months to over a year to complete. Therefore, there is frequently a delay, or regulatory lag, between the time one of our regulated subsidiaries makes a capital investment or incurs an operating expense increase and when those costs are reflected in rates. For instance, an unexpected increase in chemical costs or new capital investment that is not appropriately reflected in the most recently completed rate case will generally not be recovered by the regulated subsidiary until the next rate case is filed and approved by the state PUC. Our rate case management program is guided by the goals of obtaining efficient recovery of costs of capital and utility operating and maintenance costs, including costs incurred for compliance with environmental regulations. The management team at each of our regulated subsidiaries anticipates the time required for the regulatory process and files a rate case with the goal of obtaining rates that reflect as closely as possible the cost of providing service at the time the rates become effective. Even if rates are sufficient, we face the risk that we will not achieve the rates of return on our invested capital and a return of our invested capital that are permitted by the state PUC.

Our regulated subsidiaries also pursue methods to minimize the adverse impact of regulatory lag and have worked with state PUCs and legislatures to implement a number of approaches to achieve this result. A number of states in which our Regulated Businesses operate have adopted efficient rate policies, including some form of single tariff pricing, forward–looking test years, pass–through provisions or infrastructure surcharges. States that have adopted a full or partially single tariff pricing policy include: Pennsylvania, New Jersey, West Virginia, Kentucky, Ohio, Indiana, Illinois and Iowa.

Forward–looking test years and infrastructure surcharges reduce the regulatory lag associated with the traditional method of recovering rates from state PUCs. Forward–looking test year mechanisms allow us to earn, on a more timely basis, a return of our current or projected costs and a rate of return on our current or projected invested capital and other "known and measurable changes" in our business. Some states have permitted use of a fully forecasted test year instead of historical data to set rates. Examples of these states include: Illinois, Kentucky, New York, Tennessee and California. In all states in which we operate on a regulated basis, PUCs have allowed utilities to update historical data for some changes that occur for some limited period of time

subsequent to the historical test year. This allows utilities to take account of some more current costs or capital investments in the rate–setting process. The extent to which historical data can be updated will generally vary from state to state and whether the changes are known and measurable.

Also, an increasing number of states are permitting rates to be adjusted outside of a general rate case for certain costs, such as a return on capital investments to replace aging infrastructure or increases in expenses beyond the utility's control, such as purchased water costs. This infrastructure surcharge mechanism allows our rates to be adjusted and charged to customers outside the context of a general rate proceeding for pre–specified portions of our capital expenditures to replace aging infrastructure closer to the time these capital projects are placed in service. For example, Pennsylvania, Illinois, Missouri, Indiana, New York, California and Ohio are examples of states that have in the past allowed tariffs that permit the imposition of surcharges on customers' bills for infrastructure replacement. New Jersey, California, Virginia and Illinois have allowed surcharges for purchased water costs. California has allowed surcharges for power and conservation, and New York has allowed surcharges for certain costs such as power and chemicals. These constructive regulatory mechanisms encourage us to maintain a steady capital expenditure program to repair and improve water and wastewater systems as needed by reducing the regulatory lag on the recovery of prudent expenditures.

Also, some of the states in which we operate permit pass–through provisions that allow for an increase in certain operating costs, such as purchased power and property taxes to be passed on to and recovered from customers outside of a general rate case proceeding.

Another regulatory mechanism to address issues of regulatory lag includes the potential ability, in certain circumstances, to recover in rates a return on utility plant before it is in service, instead of capitalizing an allowance for funds used during construction. Examples of states that have allowed such recovery include: Texas, Pennsylvania, Ohio, Kentucky, Virginia, Illinois and California.

In addition, some states have permitted us to seek pre–approval of certain capital projects and associated costs. In this pre–approval process, the PUCs assess the prudency of such projects.

Recently, the state of California has decoupled revenues from water sold. This progressive regulation enables utilities to focus on conservation as revenues are not tied to sales. Also, as a result of this regulation, utilities would be less susceptible to consumption changes as a result of weather conditions.

The ability of the Company to seek regulatory treatment as described above does not guarantee that the state PUCs will accept the Company's proposal in the context of a particular rate case. However, the Company strives to use these and other regulatory policies to address issues of regulatory lag wherever appropriate and to expand their use in areas where they may not currently apply.

**Environmental, Health and Safety and Water Quality Regulation**

Our water and wastewater operations are subject to extensive United States federal, state and local, and in the case of our Canadian operations, Canadian laws and regulations governing the protection of the environment, health and safety, the quality of the water we deliver to our customers, water allocation rights and the manner in which we collect, treat, discharge and dispose of wastewater. We are also subject to certain regulations regarding fire protection services in the areas we serve. These regulations include the Safe Drinking Water Act, the Clean Water Act and other federal, state, local and Canadian laws and regulations governing the provision of water and wastewater services, particularly with respect to the quality of water we distribute. We also are subject to various federal, state, local and Canadian laws and regulations governing the storage of hazardous materials, the management and disposal of hazardous and solid wastes, discharges to air and water, the cleanup of contaminated sites, dam safety and other matters relating to the protection of the environment and health and safety. State PUCs also set conditions and standards for the water and wastewater services we deliver.

***Impairment charge.*** The impairment charge was $450.0 million for 2009 compared to $750.0 million for 2008. The 2009 amount recorded included an impairment charge to goodwill of our Regulated Businesses in the amount of $448.2 million and our Non–Regulated Businesses of $1.8 million. The 2009 impairment charge, which was recorded in the first quarter of 2009, was primarily related to the high degree of stock market volatility experienced and as of March 31, 2009, the sustained period for which the Company's market price was below its carrying value. The 2008 impairment charge was primarily due to the market price of the Company's common stock (both the initial public offering price and the price during subsequent trading) being less than what was anticipated during our 2007 annual test. Also contributing to the impairment was a decline in the fair value of the Company's debt (due to increased interest rates). See "Factors Affecting Our Results of Operations—Goodwill Impairment."

***Other income (deductions).*** Interest expense, net of interest income, the primary component of our other income (deductions), increased by $11.4 million, or 4.0%, for 2009 compared to 2008. The increase is primarily due to increased borrowings associated with capital expenditures. In addition, AFUDC decreased by $4.0 million in 2009 as compared to the same period in the prior year as a result of certain key projects being placed in–service. Other items contributing to the change include lower miscellaneous income for 2009 compared to 2008 primarily as a result of the change in market value of investments held for certain employees' elected deferred compensation.

***Provision for income taxes.*** Our consolidated provision for income taxes increased $9.6 million, or 8.6%, to $121.4 million for 2009 from $111.8 million for 2008. The effective tax rates of (108.7%) and (24.8%) for 2009 and 2008, respectively, reflect the tax effects of the goodwill impairment charges as discrete items, as the Company considers these charges as infrequently occurring or unusual. In addition to the tax benefits associated with the goodwill impairment charges 2009 included tax benefits attributable to the impact of tax law changes as well as other discrete items. The Company's annual effective tax rate was 39.3 % and 39.8 % for 2009 and 2008, respectively, excluding the impact of the goodwill impairment charges and the various other discrete items.

***Net loss.*** The net loss for 2009 was $233.1 million compared to a net loss of $562.4 million for 2008. The variation between the periods is the result of the aforementioned changes.

***Comparison of Results of Operations for the Years Ended December 31, 2008 and 2007***

***Operating revenues.*** Our operating revenues increased by $122.7 million, or 5.5%, to $2,336.9 million for 2008 from $2,214.2 million for 2007. Regulated Businesses' revenues increased by $95.2 million, or 4.8%, for 2008 compared to 2007. The Non–Regulated Businesses' revenues for 2008 increased by $29.5 million, or 12.2%, from 2007.

The increase in the Regulated Businesses' revenues was primarily due to rate increases obtained through general rate cases totaling approximately $132.8 million as well as higher revenues resulting from surcharges of $4.5 million and from customer growth and acquisitions of approximately $3.3 million. This increase was offset by a $52.3 million decrease in revenues related to lower customer consumption, mainly in our states in the Midwestern region of the United States primarily due to the extremely wet weather conditions in those areas during 2008, as well as decreased usage in 2008 compared to 2007 in New Jersey and Pennsylvania mainly due to drier weather conditions in 2007.

Our Non–Regulated Businesses' operating revenues increased by $29.5 million, or 12.2%, to $272.2 million in 2008 from $242.7 for 2007. The net increase was primarily attributable to higher revenues in our Contract Operations Group and our Homeowner Services Group, partially offset by decreased revenues in our Applied Water Management Group and Canadian Fixed Residuals. The increase in Contract Operations Group revenues was primarily attributable to incremental revenues associated with design and build contracts, as well as increased military construction and O&M project revenues. The increase from our Homeowner Service Group

*Accounting for Income Taxes*

The parent company and its subsidiaries participate in a consolidated federal income tax return for United States tax purposes. Members of the consolidated group are charged with the amount of federal income tax expense determined as if they filed separate returns.

Certain income and expense items are accounted for in different time periods for financial reporting than for income tax reporting purposes. The Company provides deferred income taxes on the difference between the tax basis of assets and liabilities and the amounts at which they are carried in the financial statements. These deferred income taxes are based on the enacted tax rates expected to be in effect when these temporary differences are projected to reverse. In addition, the regulated utility subsidiaries recognize regulatory assets and liabilities for the effect on revenues expected to be realized as the tax effects of temporary differences, previously flowed through to customers, reverse.

*Accounting for Pension and Postretirement Benefits*

We maintain noncontributory defined benefit pension plans covering eligible employees of our regulated utility and shared service operations. The pension plans have been closed for any employees hired on or after January 1, 2006. Union employees hired on or after January 1, 2001 and non-union employees hired on or after January 1, 2006 will be provided with a 5.25% of base pay defined contribution plan. We also maintain postretirement benefit plans for eligible retirees. The retiree welfare plans are closed for union employees hired on or after January 1, 2006. The plans had previously closed for non-union employees hired on or after January 1, 2002. See Note 15 of the Notes to Consolidated Financial Statements for further information regarding the accounting for the defined benefit pension plans and postretirement benefit plans.

The Company's pension and postretirement benefit costs are developed from actuarial valuations. Inherent in these valuations are key assumptions provided by the Company to its actuaries, including the discount rate and expected long-term rate of return on plan assets. Material changes in the Company's pension and postretirement benefit costs may occur in the future due to changes in these assumptions as well as fluctuations in plan assets. The assumptions are selected to represent the average expected experience over time and may differ in any one year from actual experience due to changes in capital markets and the overall economy. These differences will impact the amount of pension and other postretirement benefit expense that the Company recognizes. The primary assumptions are:

- Discount Rate—The discount rate is used in calculating the present value of benefits, which are based on projections of benefit payments to be made in the future. The objective in selecting the discount rate is to measure the single amount that, if invested at the measurement date in a portfolio of high-quality debt instruments, would provide the necessary future cash flows to pay the accumulated benefits when due;
- Expected Return on Plan Assets—Management projects the future return on plan assets considering prior performance, but primarily based upon the plans' mix of assets and expectations for the long-term returns on those asset classes. These projected returns reduce the net benefit costs we record currently;
- Rate of Compensation Increase—Management projects employees' annual pay increases, which are used to project employees' pension benefits at retirement; and
- Health Care Cost Trend Rate—Management projects the expected increases in the cost of health care.

The discount rate is subject to change each year, consistent with changes in applicable high-quality, long-term corporate bond indices. In selecting a discount rate for our pension and postretirement benefit plans, a yield curve was developed for a portfolio containing the majority of United States-issued Aa-graded non-callable (or callable with make-whole provisions) corporate bonds. For each plan, the discount rate was developed as the level equivalent rate that would yield the same present value as using spot rates aligned with the projected benefit payments. The discount rate for determining pension benefit obligations was 5.93%, 6.12% and 6.27% at December 31, 2009, 2008 and 2007, respectively. The discount rate for determining other post-retirement benefit obligations was 5.82%, 6.09% and 6.20% at December 31, 2009, 2008 and 2007, respectively.

**Construction Contracts**

Revenues from construction projects are recognized over the contract term based on the estimated percentage of completion during the period compared to the total estimated services to be provided over the entire contract. Losses on contracts are recognized during the period in which the loss first becomes probable and estimable. Revenues recognized during the period in excess of billings on construction contracts are recorded as unbilled revenue. Billings in excess of revenues recognized on construction contracts are recorded as other current liabilities until the recognition criteria are met. Changes in contract performance and related estimated contract profitability may result in revisions to costs and revenues and are recognized in the period in which revisions are determined.

Under these agreements, revenues were $28,796, $47,889 and $32,141 and operation and maintenance expenses were $25,060, $44,227 and $34,543 as of December 31, 2009, 2008 and 2007, respectively. Included in the amounts are construction revenues of $5,614, $25,766 and $12,902 and operation and maintenance expenses of $5,439, $24,852 and $12,601 related to the Company's Fillmore contract at December 31, 2009, 2008, and 2007, respectively. The construction phase of the contract was substantially complete and in service at December 31, 2009.

**Income Taxes**

The parent company and its subsidiaries participate in a consolidated federal income tax return for U.S. tax purposes. Members of the consolidated group are charged with the amount of federal income tax expense determined as if they filed separate returns.

Certain income and expense items are accounted for in different time periods for financial reporting than for income tax reporting purposes. The Company provides deferred income taxes on the difference between the tax basis of assets and liabilities and the amounts at which they are carried in the financial statements. These deferred income taxes are based on the enacted tax rates expected to be in effect when these temporary differences are projected to reverse. In addition, the regulated utility subsidiaries recognize regulatory assets and liabilities for the effect on revenues expected to be realized as the tax effects of temporary differences, previously flowed through to customers, reverse.

Investment tax credits have been deferred by the regulated utility subsidiaries and are being amortized to income over the average estimated service lives of the related assets.

The Company recognizes accrued interest and penalties related to tax positions as a component of income tax expense.

The Company accounts for sales tax collected from customers and remitted to taxing authorities on a net basis.

**Allowance for Funds Used During Construction ("AFUDC")**

AFUDC is a non–cash credit to income with a corresponding charge to utility plant which represents the cost of borrowed funds or a return on equity funds devoted to plant under construction. The regulated utility subsidiaries record AFUDC to the extent permitted by the Regulators.

**Environmental Costs**

The Company's water and wastewater operations are subject to federal, state, local and foreign requirements relating to environmental protection, and as such, the Company periodically becomes subject to environmental claims in the normal course of business. Environmental expenditures that relate to current operations or provide a future benefit are expensed or capitalized as appropriate. Remediation costs that relate to an existing condition

At December 31, 2009 and 2008, the Company had capital loss carryforwards for federal income tax purposes of $16,282 and $17,614, respectively. The Company has recognized a full valuation allowance for the capital loss carryforwards because the Company does not believe these losses are more likely than not to be recovered.

The Company files income tax returns in the United States federal jurisdiction, and various state and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state or local or non–U.S income tax examinations by tax authorities for years before 2004.

The Company has state income tax examinations in progress and does not expect material adjustments to result.

In December 2008, the Company filed a request with the Internal Revenue Service ("IRS") to change its tax accounting method for repair and maintenance costs on its utility assets. The IRS partially approved the request in October 2009, allowing the Company to take a current deduction for costs that were previously capitalized for tax purposes. As a result, the Company recorded a deferred income tax liability for this temporary difference.

The following table summarizes the changes in the Company's gross liability, excluding interest and penalties, for unrecognized tax benefits:

| | |
|---|---|
| Balance at January 1, 2008 | $ 1,642 |
| Decreases due lapse statute of limitations | (291) |
| Balance at December 31, 2008 | 1,351 |
| Increases in prior period tax positions | 88,248 |
| Increases in current period tax positions | 22,631 |
| Decreases due to lapse of statute of limitations | (209) |
| Balance at December 31, 2009 | $112,021 |

The liability balance as of December 31, 2009 and 2008 does not include interest and penalties of $439 and $312, respectively, which is recorded as a component of income tax expense. The majority of the increased tax position is attributable to temporary differences. The Company does not anticipate material changes to its unrecognized tax benefits within the next year. If the Company sustains all of its positions at December 31, 2009 and 2008, an unrecognized tax benefit of $7,785 and $1,104, respectively, excluding interest and penalties, would impact the Company's effective tax rate.

The following table summarizes the changes in the Company's valuation allowance:

| | |
|---|---|
| Balance at January 1, 2008 | $29,021 |
| Increases in current period tax positions | 2,369 |
| Decreases in prior year tax positions | (2,528) |
| Balance at December 31, 2008 | 28,862 |
| Increases in current period tax positions | 2,778 |
| Decreases in current period tax positions | (5,698) |
| Decreases in prior period tax positions | (321) |
| Balance at December 31, 2009 | $25,621 |

**Note 15: Employee Benefits**

**Pension and Other Postretirement Benefits**

The Company maintains noncontributory defined benefit pension plans covering eligible non–union employees of its regulated utility and shared services operations. Benefits under the plans are based on the

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BEFORE THE
COMMONWEALTH OF KENTUCKY
PUBLIC SERVICE COMMISSION

IN THE MATTER OF:

ADJUSTMENT OF THE RATES OF
KENTUCKY-AMERICAN WATER COMPANY

CASE NO. 2004-00103

TRANSCRIPT OF EVIDENCE

VOLUME III

DATE OF HEARING: November 10, 2004



**CONNIE SEWELL**
COURT REPORTER
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(502) 875-42

ATTY GEN. EXHIBIT 4

CHAIRMAN GOSS:

Okay. I appreciate that, Mr. Ingram, because, again, I would say the same thing to you that I said to Mr. Miller. We've got a new Commission here and, if something like that occurred, we certainly want to know about it.

MR. INGRAM:

I will include in my statement present and all former Commissioners of the Public Service Commission.

CHAIRMAN GOSS:

Okay. That's fine. All right.

MR. INGRAM:

Just a couple or three questions.

REDIRECT EXAMINATION

BY MR. INGRAM:

Q. Mr. Miller, are you aware that the Director of Governmental Relations for Kentucky-American Water Company is registered as a legislative lobbyist only? Would you know that?

A. I don't really know that, Mr. Ingram.

Q. If I told you that was the case, would you accept that?

A. I would, sir.

Q. I want to hit the dead horse a couple of times here. Does Kentucky-American send to the entity filing a



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consolidated tax return every year a check equal to 35 percent of its taxable income?

A. I've worked here 28 years in the accounting field and each and every year that has been the case because we have had taxable income.

Q. Is that what is shown on the income statements of Kentucky-American Water Company?

A. Absolutely.

Q. Does Kentucky-American Water Company ever get back from the entity filing the consolidated tax return any refund to those federal taxes?

A. No, sir.

Q. Does the entity filing the consolidated tax return take a part of the money that it has accumulated and gives it to the subsidiary that has an operating loss as a then-incurred tax benefit instead of postponing that tax benefit to a loss carry-forward year?

A. Yes, sir.

Q. The last question I'll ask you, Mr. Spenard, I think asked you about your projection of the return on equity to be achieved by Kentucky-American Water Company for the year 2004, and I believe somewhere in this massive record there's a number of 8.46 percent. Do you remember him asking you about that?

A. Yes, sir. It was attached to my testimony as Direct



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Exhibit No. 1.

Q. Does Kentucky-American monthly file its financial statements with the PSC?

A. We do.

Q. Have you filed a financial statement for the 12 months ending September 2004?

A. I have.

Q. Do you know what the earned return on equity for Kentucky-American Water Company has been for the 12 months ending September 2004?

A. Yes, sir. It's 5.2 percent.

MR. INGRAM:

I have no more questions, Your Honor.

CHAIRMAN GOSS:

Thank you, Mr. Ingram. Mr. Spenard, do you have recross limited to the scope of redirect?

MR. SPENARD:

I have two limited to the scope of redirect, and I have a request that I believe is within bounds. First, on the redirect . . .

RECROSS EXAMINATION

BY MR. SPENARD:

Q. Mr. Miller, does Pennsylvania-American send 35 percent of its taxable income to the parent as well?

A. It does. Well, let me rephrase that, Mr. Spenard. As



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BEFORE THE

KENTUCKY PUBLIC SERVICE COMMISSION

CASE NO. 97-034

RE: KENTUCKY-AMERICAN WATER COMPANY

Pursuant to notice duly given, the above-styled matter came to be heard July 1, 1997, at 10:00 A.M. in the Hearing Room of the Kentucky Public Service Commission, 730 Schenkel Lane, Frankfort, Kentucky 40601; The Honorable Linda Breathitt presiding.

VOLUME I OF II

C O P Y

VIVIAN A. LEWIS
COURT REPORTER - PUBLIC STENOGRAPHER
101 COUNTRY LANE
FRANKFORT, KENTUCKY 40601
(502) 695-1373

ATTY GEN. EXHIBIT 5

A Not at this point, no.

Q Do you have an anticipated time schedule for that filing?

A Depending on when an order is received in Case Number 93-434, we--depending on the results of that Order, we may be applying for a certificate within six to eight months.

MR. RAFF:

Thank you Ms. Bridwell. No further questions.

A Thank you.

REDIRECT EXAMINATION

BY MR. INGRAM:

Q Ms. Bridwell, I don't want to leave an implication on the record that Kentucky-American Water Company believes its construction program as budgeted should be slipped by the Commission in its Order. So, as a matter of principle I will ask you, do you believe that Kentucky-American's construction budget in this case should be slipped by the Commission?

A Not at all.

Q But I take it history of Kentucky-American's

forecasted test year cases suggests to you the probability that its construction budget will be slipped in this case?

A Unfortunately.

Q If it is slipped, do you believe that Scenario C in PSC Data Request Number 2, Item 7, represents an appropriate method for slipping the construction budget?

A I believe of the scenarios that are included, yes, it is the most appropriate.

Q That scenario excludes budget project 92-12 from the mathematical calculation, does it not?

A I'm not sure on that, you will have to ask Mr. Grubb that.

Q What is budget project 92-12?

A That is the project, the design and construction of the water supply project.

Q That Mr. Raff just asked you about when he mentioned that the cost, thereof, had been excluded by this Commission in the last two rate cases; is that correct?

A Yes.

Q If, indeed, the budget project 92-12 is

**KENTUCKY-AMERICAN WATER COMPANY**
**CASE NO. 2010-00036**
**COMMISSION STAFF'S SECOND SET OF INFORMATION REQUESTS**

---

**Witness: Keith Cartier**

18. Refer to Kentucky-American's Response to Commission Staff's First Set of Information Requests, Item 1(a), W/P3-4 at 2.

    a. According to Kentucky-American, the cleaning cost of Kentucky River Station is increasing from $184,628 to $245,000, an increase of $60,372 or 32.7 percent. Provide a detailed explanation for this increase.

    b. Explain why Kentucky-American refers to the 2011 cost to clean the Kentucky River Station as the "actual cost."

    c. For each Kentucky-American water treatment facility, list the dates in the previous ten years that the facility was cleaned, the cost of each cleaning, and the amortization period that Kentucky-American used for the cost of each cleaning.

    d. Provide the date the Kentucky River Station will be cleaned in 2011 and the basis for the cost estimate.

**Response:**

    a. The KRS I sludge lagoon cleaning project is bid, with the project awarded to the lowest qualified contractor. The project entails spreading dried material from prior lagoon cleanings in areas around the plant site in addition to removing wet material from the lagoons and placing the wet material in the drying area. Kentucky-American expects to bid the project once again, anticipating that additional site work may be required to the sludge drying area in addition to the normal work conducted as part of the clean out project.

    b. The label is not accurate. The 2011 cost is projected.

    c. The Kentucky River Station sludge lagoon was cleaned late fall 2001 ($144,000) summer 2004 ($187,529), fall of 2006 ($202,500) and summer 2009 ($184,627). The amortization periods were 24 months. The Richmond Road sludge lagoons were cleaned in the summer of 2002 ($87,572), summer 2004 ($75,769), spring of 2005 ($69,565), and fall of 2007 ($150,000). These expenses were not amortized; the first three were expensed in year incurred and the 2007 expense was accrued.

    d. The sludge lagoon project at KRS typically spans more than one month. The amortization is planned to start in July 2011, after completion of the project. The basis for the cost was historical cost plus additional costs expected for site preparation and post clean up work to the area.

For the electronic version, refer to KAW_R_PSCDR2#18_043010.pdf.

**KENTUCKY-AMERICAN WATER COMPANY**
**CASE NO. 2010-00036**
**ATTORNEY GENERAL'S SECOND REQUEST FOR INFORMATION**

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**Witness: Keith Cartier/Sheila Miller**

62. Waste disposal. Refer to the response to PSC DR1-1, WP3-4.

a. Provide the invoices and supporting documentation for the $245,000 on page 2 of 3.

b. Provide the invoices and supporting documentation for the $184,628 on page 2 of 3.

c. Provide a citation to any orders or rulings relied upon for the deferral and prospective amortization of the $245,000.

d. Explain in detail how the amortization period for the $245,000 was selected.

**Response:**

a. The $245,000 is an estimate for the KRS Lagoon cleaning to be performed June 2011. Since the expense has not been incurred there is no invoice or supporting documentation.

b. See attached.

c. The deferral and two year amortization of the KRS Lagoon has been consistent with prior filings since 2000 and has been accepted by the commission. See the Commission's Order in Case No. 2004-00103.

d. See response to part c. A two year amortization period is historically what the commission has authorized and consistent with the period KAW performs the cleaning.

For the electronic version, refer to KAW_R_AGDR2#62_052410.pdf.

# C. B. Construction Company

P.O. Box 965
233 East French Ave.
Burnside, Kentucky 42519
(606) 561-9963



12000793
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Kentucky American Water Co.
PO Box 5610
CherryHill, NJ 08034

DATE: June 2, 2009

JOB: Sludge Removal

WORK BASKET #A12SEC05

INVOICE #060209

| | |
|---|---|
| CONTRACT PRICE | $180,000.00 |
| PREVIOUS BILLINGS | -0- |
| THIS BILLING (Mobilization & Set-up) | 25,000.00 |
| BALANCE ON CONTRACT | 155,000.00 |

TOTAL AMOUNT OF THIS INVOICE $25,000.00

# C. B. Construction Company

P.O. Box 965
233 East French Ave.
Burnside, Kentucky 42519
(606) 561-9963



Kentucky American Water Co.
PO Box 5610
Cherry Hill, NJ 08034

12000793
NSX

DATE: July 15, 2009

JOB: Sludge Removal

WORK BASKET #A12SEC05

INVOICE #150709

ATTN: Mr. Joe White

| | |
|---|---|
| CONTRACT PRICE | $180,000.00 |
| PREVIOUS BILLING | 25,000.00 |
| THIS BILLING<br>100% Complete | 155,000.00 |
| BALANCE ON CONTRACT | -0- |

ADDITIONAL BILLING:

| | |
|---|---|
| Weed-eating | 2,000.00 |
| Regrading Road | 1,500.00 |
| Spraying Fence | 1,000.00 |
| Chemical (for spraying) | 127.00 |
| TOTAL AMOUNT OF THIS INVOICE | $159,627.00 |

**KENTUCKY-AMERICAN WATER COMPANY**
**CASE NO. 2010-00036**
**COMMISSION STAFF'S THIRD SET OF INFORMATION REQUESTS**

---

**Witness: John Spanos/Sheila Miller**

6. Refer to Kentucky-American's response to the Commission Staff's Second Information Request, Item 43.

   a. Kentucky-American recalculated its depreciation rates for all of the plant in service as of December 31, 2010 and the Kentucky River Station 2 costs of $163,891,660. Provide a revised schedule "Estimated Survivor Curve, Original Cost, Book Depreciation Reserve and Calculated Annual Depreciation Accruals Related to Utility Plant at December 31, 2010," pages 6 through 9, using the 13-month utility plant balances that are included in the forecasted rate base. In the revised schedule, itemize the costs of the Kentucky River Station 2 facilities, the accrual rates and the composite remaining life.

   b. Recalculate Kentucky-American's forecasted revenue requirement, rate base, and cost-of-service study to take into account the revised accrual rates.

   c. Provide all documents, state assumptions, and show all calculations used to determine the effect revised accrual rates will have on each forecasted element of revenue requirement, rate base, and cost-of-service study.

   d. Provide a reconciliation of the Kentucky River Station 2 balances used in the depreciation schedule to the Kentucky River Station 2 costs that Kentucky-American provided in its response to the Commission Staff's Second Information Request, Item 44.

**Response:**

a. Please see the attached schedule.

b.

| | Original | Revised | Variance |
|---|---|---|---|
| Revenue Requirement | $25,848,286 | $25,694,081 | ($154,205) |
| Rate Base | $362,672,028 | $362,709,889 | $37,861 |
| Depreciation Expense | $11,522,568 | $11,171,488 | ($351,080) |
| Property Tax | $4,429,174 | $4,429,581 | $407 |

c. See attached.

d. The attached schedule sets forth reconciliation of the $163,891,660 of forecasted plant utilization in response to Commission Staff Item 43 versus Item 44. The information used by Mr. Spanos in responding to PSC-2-43 utilized the utility plant balances by 300 account while the information utilized in the response to PSC-2-44 was broken down by the various contracts and not by 300 utility plant account.

For the electronic version, refer to KAW_R_PSCDR3#6_052810.pdf.

distress,'"[188] low-income customers fall within the groups for which KRS 278.170(2) permits free service or reduced rate.

Noting that the "cost is minimal and the potential benefit for the proposed recipients is great," LFUCG does not oppose the proposed discount.[189] LFUCG asserts that, given its minimal cost, the proposed discount does not appear to create an unreasonable preference or advantage for any customers. LFUCG further advocates that any Commission approval of the proposed charge should clearly state that "the proposal will not create any precedent to be used to argue for similar programs."[190]

Based upon our review of the proposed discount, we find insufficient support to establish a new customer class based solely on customer income. None of the proponents of the proposed discount have provided any convincing empirical data to demonstrate that Kentucky-American's cost of providing water service to residential customers whose annual income is equal to or less than the national poverty level significantly differs from those whose annual income is greater than the national poverty level. Discount proponents have also failed to provide any statutory or decisional authority for the proposition that customer income levels may constitute a reasonable basis to distinguish customers for cost-of-service purposes. In the absence of both empirical evidence and statutory or decisional legal authority, we must conclude the proposed discount is a unreasonable preference or advantage to a class of customers

[188] *Id.* at 7.

[189] LFUCG Brief at 29.

[190] *Id.*

BEFORE THE
COMMONWEALTH OF KENTUCKY
PUBLIC SERVICE COMMISSION

IN THE MATTER OF:

ADJUSTMENT OF THE RATES OF
KENTUCKY-AMERICAN WATER COMPANY

CASE NO. 2004-00103

# TRANSCRIPT OF EVIDENCE

## VOLUME III

DATE OF HEARING: November 10, 2004



**CONNIE SEWELL**
COURT REPORTER
1705 SOUTH BENSON ROAD
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(502) 875-4277

MR. CHILDERS:

Yes, sir.

Q. Mr. Miller, the company has proposed this low-income discount as part of its rate case, and my question to you is you have indicated in data responses that philosophically it's no different than requiring the cost of service to a particular area to be borne systemwide rather than by customers in a particular area. Can you explain that and expound on that, please?

A. I'll attempt to, Mr. Childers.

Q. Okay.

A. I mean, cost of service studies per se are averaging and allocating costs to entire classes of customers. I mean, the true fact is the true cost to each customer is probably different, but it's just not feasible, if you will, to try to set up tariffs like that so that each customer per se would have their own tariff. This is a class of customers that, you know, I think it's reasonable to address. They're the most needy people in our community here, and I think it's appropriate and reasonable, from our looking at things, in a cost of service to do or attempt to do something to assist those customers who have the most need. I think that falls within the broad cost of service type allocations



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that we deal with in the regulated business.

Q. Thank you, Mr. Miller, and you've indicated, I believe, earlier that the estimated cost is 2.5 cents per month per customer?

A. Yes, sir. That's our estimate based on what's occurred in other jurisdictions.

Q. You were asked in a data request from the Public Service Commission in their Third Set of Information Requests, and this was No. 55, whether Kentucky-American's stockholders considered increasing their contribution to the fund and, in your response, you indicated that, "The Company does review its contributions to the community annually and will review the funding of this item in relation to the level of assistance requested from the Program and consider an increase to this program in relation to the numerous requests the Company receives for funding ..." from other community organizations, and my question to you is two part. My understanding is that, as part of this rate case, the activation fee is being proposed for the first time, which is a $24 fee for new service or, when someone moves, they will pay the - it's basically a hook-up fee. Does that apply to the low-income customers as well?

A. The activation fee itself?



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Q. Yes.
A. Yes, it would apply to each and every customer that fell under the conditions of that tariff.
Q. And would the company have any objection to the Water for Life program, which is a separate program funded by stockholders, being used in part to assist low-income customers to pay that activation fee if that's a problem for low-income customers?
A. The company would have no objection to that.
Q. Well, it's true, though, that, for 2005, the company has only budgeted $5,000 as a contribution for the Water for Life program; correct?
A. That's true; yes, sir.
Q. Now, in response to the Public Service Commission's Third Set of Information Requests, No. 47, you were asked to talk a little bit about the Pennsylvania-American program and to review that, and you indicated that, in discussions with the President, the Vice President of Finance and Director of Rates for Pennsylvania-American Water Company, the company learned of the low-income tariff in place and the manner in which it was implemented and operated, and, based on those discussions, there was a positive reaction and the impact the tariff had experienced was a positive experience. Can you explain that and your

discussions with those folks?

A. Yes, sir. I mean, it's normal in American Water Works that people in positions similar, Director of Rates, VPs of Finance, we get together and we talk about what's going on around in the various jurisdictions, and this was just a meeting we had to talk about general rate matters that it came up. This was something that Pennsylvania had done sometime ago. There had been a very positive reaction from the customer base up there regarding the program, and, based on those discussions, I felt that, and I agreed, that this seemed to be a reasonable type program for the company to request, and each rate case that I've been involved with in Virginia - or not Virginia; I'm sorry - but West Virginia, Kentucky, and now file in Tennessee, we've filed similar tariffs, because we think they're appropriate and reasonable and, you know, designed to help those customers who have the most need at a very small cost to the rest of the customer base.

Q. Is it a simple and easily implemented tariff, in your opinion?

A. Absolutely. Once we have a third-party organization certify the eligibility according to the Federal Poverty Guidelines, we simply go in and simply make a tick in the customer file that that tariff applies and,



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from there forward, it will be applied.

Q. Okay. As to the cost of service issue, Mr. Miller, is the cost of service to the low-income - the cost of service to the low-income community, is it higher due to higher credit and collection costs, in your opinion?

A. I don't have any specific data about that. I could give you my opinion. Yes, I think generally the lower-income people have more trouble meeting their payments than the affluent, if you will. I mean, that's a common sense answer, if that's good enough, sir.

Q. And it costs money for the company to go out and collect those bills; correct?

A. Yes, sir.

Q. So, if that is assisted in any way, it would lower the overall collection costs anyway for the company, in your opinion?

A. I think that would be an auxiliary benefit from this program; yes, sir.

MR. CHILDERS:

That's all I have. Thank you very much.

CHAIRMAN GOSS:

Thank you, Mr. Childers. Mr. Barberie, do you have questions?

MR. BARBERIE:

I have a few, Your Honor.



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BEFORE THE
COMMONWEALTH OF KENTUCKY
PUBLIC SERVICE COMMISSION

IN THE MATTER OF:

ADJUSTMENT OF THE RATES OF
KENTUCKY-AMERICAN WATER COMPANY

CASE NO. 2004-00103

TRANSCRIPT OF EVIDENCE

VOLUME II

DATE OF HEARING: November 9, 2004



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ATTY GEN. EXHIBIT //

doesn't try to set rates, during the period that the rates from the case are going to be effective, taking into account known and measurable changes, trying to determine what the costs are going to be in that rate year.

Q. Okay. Do you believe that the utility receives a benefit by being able to file a rate case using a forecasted test period?

A. I don't know that I fully understand that question, Mr. Spenard.

Q. Let's rephrase it. Do you believe that the utility, Kentucky-American, receives a benefit by being able to file a rate case using a forward-looking test period?

A. I don't think I would classify it as a benefit or a detriment either one. I think what a forecasted test year is intended to do is what you do in an historical test year and that is to determine what are the costs going to be in the period that rates are being set in order to permit the company an opportunity to achieve an ROE that's authorized by the Commission and, in doing so, setting fair and just rates. A forecasted test year is just one method of doing that. There are others.

Q. And, in Kentucky, Kentucky-American has the option of choosing between an historic test period and a



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forecasted test period; is that correct?

A. I believe that we have that option, but I believe we also, if we revert back to the historical test year, we must stay there; that we're not - I don't think we're freely able to just decide in any particular case which one we'll do.

Q. Okay. But, at some stage, Kentucky-American made the election to use a forecasted test period and they felt that it was more beneficial than using an historic test period.

A. It is a method - yes. We think the forecasted test year is the best way to look at what the costs are going to be in the period that rates will be established in any rate case. We think that's the best of all methods. To define it as some kind of benefit, I don't know that I agree with that. It is a method of determining fair and just rates in this case and we think it's the proper way to do it.

Q. Okay. On Page 12 of your testimony, you discuss the Service Company reorganization. Would you turn to Page 12?

A. Certainly, sir. Give me just one second.

Q. Okay.

A. I gotcha.

Q. Okay. Now, can you update us on the status of these



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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 | ) | |

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# DIRECT TESTIMONY OF MICHAEL A. MILLER

October 31, 2008

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ATTY GEN. EXHIBIT 12

RATE BASE – KRS II PROJECT

38. Q. DOES THE COMMISSION NORMALLY INCLUDE CWIP IN THEIR DETERMINATION OF RATE BASE?

A. Yes. The Commission has historically included CWIP as rate base, but normally calculates a non-cash AFUDC amount related to that CWIP which is included in going-level revenues at present rates as a non-cash offset to the revenue requirement associated with CWIP.

39. Q. DID THE COMPANY INCLUDE THE CWIP FOR THE KRS II PROJECT IN ITS THIRTEEN-MONTH AVERAGE CWIP FOR THE FORECASTED TEST-YEAR IN THIS CASE?

A. Yes. The total 13-month average CWIP expenditure for KRS II through May 2010 equals $98.203 million which is included in the determination of the 13-month average CWIP included in rate base in this case.

40. Q. DID THE COMPANY CALCULATE THE AFUDC OFFSET ON THE ENTIRE CWIP BALANCE FOR THE KRS II PROJECT INCLUDED IN THE RATE BASE REQUESTED IN THIS CASE?

A. No. Through May 2009 the Company is forecasting to have expended $66.570 million for CWIP on the KRS II Project. The Company eliminated that amount of CWIP from the AFUDC calculated for the forecasted test-year. The Company did include AFUDC on the remaining CWIP included in

**the case related to the other CWIP projects and the expenditures for the KRS II Project from June 1, 2009 through May 31, 2010 in the amount of $3.095 million.**

**41. Q. WHY DID THE COMPANY NOT CALCULATE AFUDC ON THE $66.570 MILLION OF CWIP?**

**A. The KRS II project is expected to cost $162.741 million which will increase the Company's rate base by approximately 80% over the level of rate base approved in case number 2007-00143. If no rate increase associated with the $162.741million KRS II cost is embedded in rates (cash revenue) until completion of the KRS II Project in 2010, a significant rate increase will occur at that time. The Company believes the better approach for its customers would be to phase-in a portion of the cost of the KRS II Project in this case, thus avoiding the rate shock that would occur if the full cost of the KRS II Project were passed to the customers in one rate case.**

**42. Q. WHY DO YOU BELIEVE THE APPROACH PROPOSED BY THE COMPANY REGARDING THE KRS II PROJECT BENEFITS THE CUSTOMERS?**

**A. In addition to the rate shock issues addressed in the previous answer, if the Company's approach in this case is not accepted, additional AFUDC will be capitalized to the KRS II Project. That additional AFUDC would add approximately $7.263 million to the KRS II Project cost. The additional**

**KRS II Project cost for AFUDC will then have to be recovered from the customers over the book life of the KRS II Project. The Company believes the phase-in of the $66.570 million of CWIP in the rate increase in this case will be less costly to the customers than recovering the additional AFUDC over the book life of the assets constructed in the KRS II Project.**

**43. Q. DID THE COMPANY MAKE THE COMMISSION AND ALL PARTIES TO THE CERTIFICATE CASE NUMBER, 2007-00134 FOR THE KRS II PROJECT AWARE OF ITS INTENT TO SEEK FULL RATE BASE TREATMENT FOR A PORTION OF THE COST OF THE PROJECT OVER TWO RATE CASES?**

**A. Yes. In the certificate case (case number 2007-00134) I provided a number of rate impact schedules in response to discovery requests, as well as in my testimony in that case. The Company consistently indicated in the testimony in that case its intent to seek a phase-in of the rate impact of the KRS II Project over two general rate cases.**

**44. Q. CAN YOU DEMONSTRATE THE BENEFIT OF INCLUDING THE $66.570 MILLION AS FULL RATE BASE IN THIS CASE?**

**A. Yes. Attached to this testimony is Exhibit MAM-7, which shows on a present value basis the cost to the customers is lower under the approach proposed by the Company in this case versus the full AFUDC approach over the book life of the Project.**

**On page 1 of 2 of Exhibit MAM-7 is an estimate of the revenue requirement calculation over the book life of the project using the traditional CWIP approach with full AFUDC capitalized to the project. Under this approach an additional $7.263 million of AFUDC would be capitalized above the level proposed in the Company approach and the original cost of the KRS II Project would be $170.024 million.**

**On page 2 of 2 of Exhibit MAM-7 is an estimate of the revenue requirement calculation over the book life of the project using the phased-in approach for the CWIP on the KRS II Project as proposed by the Company in this case. This approach will avoid the additional AFUDC on the $66.570 million of CWIP if approved for full base rate recovery in this case. The Company's phased-in approach to rate recovery of the KRS II Project will hold the estimated cost of the KRS II Project to $162.731 million.**

**The following table shows the differences in the cost of the KRS II Project under the two approaches, as well as the Net Present Value of the rate recovery over the life of the project.**

| (000) Omitted | Cost of Project | Net Present Value of Rate Impact |
|---|---|---|
| Traditional Rate Making Approach – Full AFUDC | $170,024 | $240,841 |
| Phased-in Approach for CWIP as Proposed by Company in this Case | $162,741 | $220,113 |
| Savings under Phased-in Approach | $7,283 | $20,728 |

The table above demonstrates that the customers will benefit from lower rates over the life of the KRS II Project if the Company's phased-in approach is approved in the case.

## PENSIONS

45. Q. WOULD YOU DESCRIBE THE COMPANY'S PENSIONS EXPENSE INCLUDED IN THE RATE FILING?

A. Yes. The Kentucky Commission has historically regulated the Company's pension expense under the accrual or FAS 87 basis. The Company has included the forecasted pension expense for the forecasted test-year using the FAS 87 expense. The Company included FAS 87 pension expense for the forecasted test-year of $581,701. The pre-capitalized FAS 87 pension expense was obtained from forecasts prepared by AWW's actuary, Towers Perrin, for the years 2009 and 2010. The Company adjusted the Towers Perrin forecasted number to reflect the percentage charged to O&M expense at 78.94%.

# Formula for Remaining Life Depreciation

$$\frac{\text{Plant + (Plant x Negative Net Salvage Percent) - Accumulated Depreciation}}{\text{Remaining Useful Life}} = \text{Annual Depreciation Accrual}$$

$$\frac{\text{"Future Accruals"}}{\text{Remaining Useful Life}} = \text{Annual Depreciation Accrual}$$

## Assumptions - Example 1

$ 100.00 Plant Cost
zero Accumulated Depreciation
**none** **Negative Net Salvage Percent**
10 years Remaining useful life

$$\frac{\$100}{10 \text{ years}}$$

Result: Annual Depreciation Expense = $10 per year

## Assumptions - Example 2

$ 100.00 Plant Cost
zero Accumulated Depreciation
**100%** **Negative Net Salvage Percent**
10 years Remaining useful life

$$\frac{\$100 + (\$100 \times 100\%) - \$0}{10 \text{ years}}$$

$$\frac{\$200}{10 \text{ years}}$$

Result: Annual Depreciation Expense = $20 per year

## Assumptions - Example 3

$ 100.00 Plant Cost
zero Accumulated Depreciation
**20%** **Negative Net Salvage Percent**
10 years Remaining useful life

$$\frac{\$100 + (\$100 \times 20\%) - \$0}{10 \text{ years}}$$

$$\frac{\$120}{10 \text{ years}}$$

Result: Annual Depreciation Expense = $12 per year