COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

Application of Kentucky Water Service Corporation of Kentucky For an Adjustment of Rates	) Case No. 2008-00563

BRIEF

I. The Company

Water Service Corporation of Kentucky ("WSCK" or the "Company"), is a wholly owned subsidiary of Utilities, Inc. (UI). It currently serves approximately 7,991 water connections. These customers are located in Hickman and Bell Counties. WSCK maintains an operations office in both Clinton and Middlesboro. Customer payments, meter readings, and service orders are processed from the Middlesboro office. Administrative functions such as accounting, data processing, and human resources are performed from the Utilities, Inc. office in Northbrook, Illinois and management from its Charlotte, NC regional office.

As explained by Ms. Georgiev in her prefiled testimony, WSCK's parent, UI, is unique within the water and sewer industry in many respects. From its inception almost 40 years ago UI has concentrated on the purchase, formation and expansion of smaller water and/or sewer utility systems. Currently, UI has over 90 systems that provide service to approximately 300,000 customers in 15 states. This affiliation with UI has many benefits for WSCK customers. One of the primary benefits is that WSCK has access to a large pool of human resources to draw upon. There are experts in various critical areas, such as construction, engineering operations, accounting, data processing, billing, regulation, customer service, etc. UI has the highest level of combined expertise and level of experience in a more cost effective manner.

By concentrating on operating water and sewer systems, UI personnel have the ability to meet the challenges of the rapidly changing utility industry. Because the UI companies are focused on the water and sewer industry, its companies can leverage its market placement. For example, UI's access to capital is available for improvements and expansion at a reasonable cost to all of its operating companies. With increasingly more stringent health and environmental standards, ready access to capital will prove vital to continued quality service in the water and sewer utility business.

In addition, the UI group of companies has national purchasing power that results in lower costs to rate payers. Expenditures for insurance, vehicles, chemicals and meters are a few examples of purchases where national contracts provide tangible benefits to rate-payers. The Commission has recognized the benefits of consolidated water operations. In Administrative Case 366, Order dated August 19, 1998, page 4, the Commission commented that small water utilities might not be able to meet SDWA requirements. It also said that economies of scale would provide larger utilities to be better positioned than smaller ones to develop adequate plant facilities and staff resources. UI provides WSCK the very economies of scale that the Commission believes necessary for the safe efficient operation of small water utilities.

However, even with the benefits of UI, WSCK is not able to meet its operating costs and earn a reasonable return on its investment in the WSCK system with its present rates. WSCK's current income statement is shown in the Application, Schedule B. For the test year ended June 30, 2008, WSCK earned a 0.94% return on its rate base, which is 8% lower than the return recommended by the Company's rate of return witness, Pauline M. Ahern. The Company's current return on rate base is also well below its cost of capital. Adding to that financial impact, according to the United States Department of Labor Bureau and Labor Statistics, the cost of water and sewer maintenance has increased approximately by 3.514% per year since the last rate case. Without satisfactory rate relief, WSCK ability to continue to provide safe, reliable and efficient water and sewer utility services to its customers will be placed in jeopardy, and WSCK will be unable to meet its financial obligations. In addition, capital will become more costly. (See generally, Georgiev Prefiled Testimony)

II. Revenue Requirement Issues

To accurately calculate the cost of WSCK's operations, the following adjustments were made to the June, 2008 test year income statement:

- Revenues are annualized at proposed rates using the average test year customers;
- Uncollectible Accounts are adjusted based on the percentage of uncollectible accounts to revenues in the test year applied to pro forma proposed revenues;
- Salaries, Wages and Benefits are adjusted to annualize as of the end of the year;
- Regulatory Commission Expense has been adjusted to reflect the cost of the current rate case over 3 years;

- Depreciation and Amortization Expense are annualized. Depreciation expense represents gross depreciable plant at the end of the year plus pro forma projects multiplied by their respective depreciation rates;
- Taxes other than Income is adjusted for annualized payroll taxes, Utility Commission Taxes, and Gross Receipts Taxes;
- Income Taxes are computed on taxable income at current rates;
- AFUDC is eliminated for rate making purposes;
- Interest on debt is computed using a 53.03%/46.97% debt/equity ratio and a 6.58% cost of debt; and;
- A consumer price index increase of 3.514% has been included;
- Allocation of Insurance Expense adjustment was booked;
- Adjustments to allocations were based on a new allocation methodology;
- Allocation of transportation expense was booked;
- Operating expense charged to plant has been adjusted for projected increases in salaries, taxes, and benefits for operators.
- Expenses for Clinton sewer operations have been reduced to actual expense reductions.

Additionally, the following adjustments were made to rate base:

- Working capital has been calculated based on pro forma expenses;
- Pro forma plant is adjusted for a pro-forma project and CC&B (new billing system) closed out after the test year but before the filing of the rate case;
- Accumulated depreciation has been adjusted for planned additional capital investments, retirements, and plant held for future use;

- Plant Additions for July '08 to November '08 prorate to March '09;
- General ledger additions and associated accumulated depreciation up to rate base cut off date and other rate base items and associated accumulated depreciation due to change in allocation methodology are included;
- WSC and regional rate base adjustment based on new ERC allocation methodology.
- Transportation equipment has been reduced due to operator time for Clinton sewer operations.

The impact of these adjustments necessitates an annual increase in water revenues for WSCK of $816,101, (Application Exhibit 4, Schedule B) which results in an approximate 50.8% increase in the current rates for customers in Middlesboro and Clinton. (Application Exhibit 2) In the prior case, Case No. 2005-00325, WSCK proposed no change was made to the existing rate design due to the disparate impact of a unified rate on the customers of Clinton and Middlesboro. Because of the agreement in the prior case, the rate design was not changed in this case.

At the hearing a question was raised about the post test year adjustments to plant. Ms. Georgiev testified that those additions were known and measurable and in service at the time of the filing of the application. She also referred to WSCK Response 7 to the Commission's Order of May 1, 2009. In that response she described the in service dates for the projects and that the rate base, capital, revenues and expenses have been updated to reflect those additions. As a result of these adjustments, the post test year additions meet the requirements of known and measurable for purposes of an historical test year.

(Georgiev, Hearing Testimony [HT] 11:58; 12:13) An updated schedule of general ledger additional was provided with the August 26th Hearing Responses.

She was also questioned about the double billing of certain rate case expenses. WSCK employee rate case expenses are capitalized and subtracted from total hours allocated to WSCK. (Georgiev HT 12:04) This eliminates the possibility of double collection of those expenses. Her total yearly hour worked was also questioned. Most of the Company's employees work significantly more than 40 hours per week. (Georgiev HT 12:01) Sixty or more hours is not uncommon. Given the work schedule and the fact that several rate cases overlap and can extend into two calendar years, the number of hours spent on rate cases is not unreasonable or unjustified. However, the most recent capitalized rate case expenses for the WSCK are listed in the attachment to the Hearing Responses filed on August 26th .

III. Cost of Capital

The Company proposes that its rates be determined utilizing the rate of return on rate base methodology. The Company has a large rate base and needs to earn a rate of return that is sufficient to attract the necessary equity and debt capital that a larger utility needs for sound operation. Its expert witness for cost of capital, Pauline Ahern, whose prefiled testimony recommends that the Commission authorize the Company the opportunity to earn a range of common equity cost rate of 11.60%-12.10%, with a midpoint of 11.85% on the common equity financed portion of its jurisdictional rate base. A common equity range cost rate of 11.60%-12.10% results in a range of overall rate of return of 8.94% - 9.17% (midpoint of 9.06%) based upon the consolidated capital structure at June 30, 2008 of Utilities, Inc., the parent of WSCK, which consisted of 53.03% total debt and 46.97% common equity.

Because WSCK's common stock is not publicly traded, a market-based common equity cost rate cannot be determined directly for WSCK. Therefore, an assessment of the market-based cost rates of companies of relatively similar risk, i.e., proxy group(s), for insight into a recommended common equity cost rate applicable to WSCK and suitable for cost of capital purposes was necessary. Using other utilities of relatively comparable risk as proxies is consistent with the principles of fair rate of return established in the Hope[1] and Bluefield[2] cases and adds reliability to the informed expert judgment used in arriving at a recommended common equity cost rate. However, no proxy group can be selected to be identical in risk to WSCK and therefore, the proxy groups' results must be adjusted to reflect the greater relative business risk of WSCK due to its smaller relative size.

The recommendation results from the application of four well-tested market-based cost of common equity models, the Discounted Cash Flow (DCF) approach, the Risk Premium Model (RPM), the Capital Asset Pricing Model (CAPM), and the Comparable Earnings Model (CEM). A range of the common equity cost rate, before any adjustment for business risk, of 11.25% - 11.75% is indicated based upon the application of all four models to the market data of the proxy groups. The indicated common equity cost rates relative to both proxy groups were then adjusted upward by 35 basis points (0.35%) to reflect WSCK's increased business risk, due to its smaller size, relative to both proxy groups. After the adjustment, the recommended range of common

---

1 Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944).

2 Bluefield Water Works Improvement Co. v. Public Serv. Comm'n, 262 U.S. 679 (1922).

equity cost rate is 11.60% - 12.10%, with a midpoint of 11.85%, and is applicable to the Company's requested common equity ratio of 46.97% at June 30, 2008

The basis of selection for the proxy group of seven AUS Utility Reports water companies were those companies which meet the following criteria: 1) they are included in the Water Company Group of AUS Utility Reports (January 2009); 2) they have Value Line or Reuters consensus five-year EPS growth rate projections; 3) they have a Value Line adjusted beta; 4) they have not cut or omitted their common dividends during the five years ending 2007 or through the time of the preparation of this testimony; 5) they have 60% or greater of total net operating income derived from and 60% or greater of total assets devoted to regulated water operations; and 5) which, at the time of the preparation of this testimony, had not publicly announced that they were involved in any major merger or acquisition activity.

Because of the small number of publicly traded water companies available for use as proxies for WSCK as well as the limited availability of comprehensive marketability for those companies, a proxy group of gas distribution companies was also used. Like water companies, these gas distribution companies deliver a commodity, i.e., natural gas to customers through a similar distribution system.

WSCK has greater business risk than the average proxy group company because of its smaller size relative to the proxy group, whether measured by book capitalization or the market capitalization of common equity (estimated market value for WSCK, whose common stock is not traded). WSCK's smaller size as shown on page 3 of Schedule PMA-1, i.e., total permanent capital of $4.235 million at fiscal year end 2007 relative to average total permanent capital of

$662.565 million in 2007 for the proxy group of seven AUS Utility Reports water companies, $1.449 billion for the proxy group of ten AUS Utility Reports natural gas distribution companies indicates greater relative business risk because all else equal, size has a bearing on risk.

Another factor contributing to the risk effects of size include the fact that investors demand greater returns to compensate for a lack of marketability and liquidity. Because WSCK is the regulated utility to whose rate base the Commission's ultimately allowed overall cost of capital and fair rate of return will be applied, the relevant risk reflected in the cost of capital must be that of WSCK, including the impact of its small size on common equity cost rate. Size is an important factor which affects common equity cost rate, and WSCK is significantly smaller than the average company in the proxy group based upon total investor-provided capital.

Therefore, it is necessary to upwardly adjust the common equity cost rate range of 11.25% and 11.75% based upon the two proxy groups. Based upon WSCK's size, an adjustment of 3.62% (362 basis points) is necessary to reflect its size relative to the market-based common equity cost rates of the seven AUS Utility Reports water companies and an adjustment of 4.32% (432 basis points) is necessary to reflect its size relative to the ten AUS Utility Reports natural gas distribution companies. These adjustments are based upon data contained in the Ibbotson SBBI – 2008 Valuation Yearbook.

The determinations are based on the size premia for decile portfolios of New York Stock Exchange (NYSE), American Stock Exchange (AMEX) and NASDAQ listed companies for the 1926-2007 period and related data shown on pages 3 through 17 of

Schedule PMA- PMA-1. The average size premium for the decile in which each proxy group falls has been compared to the average size premium for the 10th decile in which WSCK would fall if its stock were traded and sold at the January 2, 2009 average market/book ratio of 197.5% and 193.1% experienced by each proxy group, respectively. As shown on page 3 of Schedule PMA- 1, the size premium spread between WSCK and the seven AUS Utility Reports water companies is 3.62% and between WSCK and the ten AUS Utility Reports natural gas distribution companies is 4.32%. Page 4 contains data in support of page 3 while pages 5 through 17 of Schedule PMA-1 contain relevant information from the Ibbotson SBBI – 2008 Valuation Yearbook discussed previously.

Consequently, a business risk adjustment of 3.62% is indicated based upon the seven AUS Utility Reports water companies and 4.32% is indicated based upon the ten AUS Utility Reports natural gas distribution companies. However, Ms. Ahern made what she called a conservatively reasonable business risk adjustments of 0.35% (35 basis points) as shown on Line No. 6 on page 2 of Schedule PMA-1 to the indicated common equity cost rate range of 11.25% to 11.75%. This results in an indicated business risk adjusted common equity cost rate range of 11.60% to 12.10% (with a midpoint of 11.85%) as shown on Line No. 7, which is the recommended common equity cost rate range.

A common equity cost rate range of 11.60%-12.10%, when applied to the Company's requested common equity ratio of 46.97% estimated at June 30, 2008 results in a range of overall rate of return of 8.94%-9.17% which is both reasonable and conservative and will provide WSCK with sufficient earnings to enable it to attract necessary new capital.

At the hearing a question was raised about the need for additional capital and additional investment due to the Company's recovery of depreciation. Because the water industry is much more capital-intensive than the electric, natural gas or telephone industries, the investment required to produce a dollar of revenue is greater. And, because investor-owned water utilities typically do not receive federal funds for infrastructure replacement, the challenge to investor-owned water utilities is exacerbated and their access to financing is restricted, thus increasing risk. (Ahern HT 10:48)

The National Association of Regulatory Commissioners (NARUC) has also highlighted the challenges facing the water and wastewater industry stemming from its capital intensity. NARUC's Board of Directors adopted a resolution in July 2006, taking the position that[3]:

> WHEREAS, To meet the challenges of the water and wastewater industry which may face a combined capital investment requirement nearing one trillion dollars over a 20-year period, the following policies and mechanisms were identified to help ensure sustainable practices in promoting needed capital investment and cost-effective rates: a) the use of prospectively relevant test years; b) the distribution system improvement charge; c) construction work in progress; d) pass-through adjustments; e) staff-assisted rate cases; f) consolidation to achieve economies of scale; g) acquisition adjustment policies to promote consolidation and elimination of non-viable systems; h) a streamlined rate case process; i) mediation and settlement procedures; j) defined timeframes for rate cases; k) integrated water resource management; l) a fair return on capital investment; *and* m) improved communications with ratepayers and stakeholders; *and*
>
> WHEREAS, Due to the massive capital investment required to meet current and future water quality and infrastructure requirements, adequately adjusting allowed equity returns to

3 "Resolution Supporting Consideration of Regulatory Policies Deemed as 'Best Practices'", Sponsored by the Committee on Water. Adopted by the NARUC Board of Directors, July 27, 2006.

> recognize industry risk in order to provide a fair return on invested capital was recognized as crucial…
>
> RESOLVED, That the National Association of Regulatory Utility Commissions (NARUC), convened in its July 2006 Summer Meetings in Austin, Texas, conceptually supports review and consideration of the innovative regulatory policies and practices identified herein as "best practices;" *and be it further*
>
> RESOLVED, That NARUC recommends that economic regulators consider and adopt as many as appropriate of the regulatory mechanisms identified herein as best practices…

Over the past five years, capital spending has been equivalent to about three times depreciation expense. However, companies are now forecasting spending to be at or above four times depreciation expense over the intermediate term. Standard & Poor's, Credit Outlook For U.S. Investor-Owned Water Utilities Should Remain Stable in 2008 (January 31, 2008) 2, 4.

IV. Capital Improvements

There are several significant improvements to the operations of WSCK which affect improved service to customers and which impact the need for additional rates. UI and its predecessors had not made a significant investment in technology in quite some time. Antiquated systems, lack of integration, and the lack of standardization were beginning to have an adverse effect on the Company and its customers. Accordingly, UI set out to improve the Company's capabilities and processes in the accounting, customer service, customer billing and financial and regulatory reporting areas. After a detailed review of its options, including a recommendation from the independent Deloitte, (Williams HT 10:53), UI began the process of adopting and implementing what has become know as Project Phoenix. The implementation of this Company wide improvement began in early 2006 with a series of internal and external evaluations, which culminated in a business case presentation by Deloitte to the Company in September 2006. The business case identified:

- Drivers for Change,
- Current State Overview,
- Recommended Solutions,
- Future State, and
- Benefits to Stakeholders.

The business case presentation confirmed UI's initial evaluations that:

- Fragmented and non-standardized processes were complex and inefficient, with an attendant risk of error and control breakdown,
- The infrastructure unnecessarily placed stress on the Company's human capital,
- The Company's legacy financial and customer care systems were either fully customized or unsupported, or both, which resulted in a risk of breakdown and impeded management's ability to obtain information to make decisions, and
- Use of spreadsheets made ensuring accuracy and control difficult, resulting in the potential for errors in operation and regulatory reports.

After the business case presentation and an evaluation of potential solutions, UI management selected JD Edwards Enterprise One ("JDE") as the financial system, including asset management, and Oracle's Customer Care and Billing System ("CC&B") as the customer information system. These systems are integrated in a manner that allows for the sharing of crucial information between the Company's different operational organizations. JDE is a web-based software system that allows easy access from multiple locations. It is composed of the following modules:

Accounts Payable
UI will use the accounts payable system for cash management. It will be used to issue checks, perform electronic funds transfer, and perform bank reconciliation and expense reimbursements.

Human Resources / Time Capture
UI's Human Resources organization will use JDE to manage employee information. This includes the management of personal information, benefits administration, health and safety, job information and more. The time capture module enables all employees to enter their time for tracking purposes, approved by their supervisor, and charge it directly to capital projects, if applicable.

Requisitioning
Requisitioning is handled within the procurement module of JDE, covering purchases from outside vendors. The procurement module will be used to record and track purchases against capital projects, assets such as maintenance and replacement parts, IT related purchases and various other purchases such as office supplies and furniture. The procurement module approval process will also be used to record capital project approval.

Capital Projects
The Capital Project/job cost functionality covers the project budget setup and schedule, management of the project and monitoring of cost. UI will use these functionalities in order to improve visibility of project status wherever access to JDE is available. As cost and purchases are updated in JDE, this same information can be viewed in real-time. Capital project approvals are also included in JDE using the procurement module approval process.

Fixed Assets
The Fixed Assets functionality covers the asset management requirements of UI. Assets will be tracked throughout their entire lifetime, including automatic depreciation, retirements and tax calculations.

Equipment Management
The equipment management functionality enables equipment tracking, servicing, and maintenance and cost effectiveness. Managers can track equipment by type, manufacturer, year, service history and other information.

General Ledger

The General Ledger integrates financial information in real time from throughout UI and helps meet the financial consolidation and reporting needs of the business.

These system upgrades improve the Company's ability to record and retrieve data. Because of this functionality, UI, its customers and regulators should see marked improvement. The system has enhanced record keeping and retrieval functions, making production of financial and regulatory reports easier. In addition, the reports should be more accurate, which benefits customers by improving the management decision making process and allowing the Company to more efficiently deliver reliable information to regulators. The system also reduces manual effort and reliance on spreadsheets, which again improves the reliability of reports. The Capital Projects module allows employees to view and track projects in real-time. Employees should be able to manage projects and costs in a more effective manner, which benefits the Company and customers

JDE was placed in service on December 3, 2007. The total cost of the JDE system as of March 31, 2008 was $14,544,020. Approximately $367,498 was allocated to WSCK. (William's prefiled testimony, page 8).

CC&B is a web-based software system. The web-based feature allows for quicker return of information to the user and allows for "quicker fixes" should the system go down involuntarily, or need to go down for routine maintenance. CC&B is composed of the following modules:

Customer Management and Service
This module covers activities including creation and management of customers, accounts and premises. It also manages customer inquiries, creation and management of service orders, starting and stopping service, and other related functions.

Billing
This module covers activities including creation and management of rates/tariffs, bill estimation, bill generation and print, cancel/rebills and 3rd party billing.

Accounts Receivables & Collections
This module covers payments, adjustments, payment arrangements, LPC disconnects, collection agency referrals and write-offs.

Device Management
This covers activities including definition of meters and other equipment (e.g., back flow devices), meter installation and testing.

Meter Reading
This covers activities including meter reads, meter read uploads and downloads and meter read schedules/routes.

CC&B has a number of benefits over UI's legacy customer care and billing system, which was fully customized and unsupported. The prior system had several weaknesses, for example, customer and premise information were linked in one account. As residents moved, the service order history at the premise was purged and prior service activities eventually became unavailable for viewing. This resulted in the loss of valuable information. In addition, field personnel were sent daily service orders either through email or fax. They did not have access to the legacy billing system. Upon completion of the service orders, the information was emailed or faxed back to the billing office for closure of the orders. The process was manually intensive and led to untimely responses due to incomplete fax transmissions. Additionally, as customers moved from one premise to another within the Company, they were issued a new account number. There was no efficient means of tracking a customer and transferring payment information, service history and billed services (debt) from one account to another.

CC&B offers the ability to focus on either a customer or a premise. Field activity information at a premise is stored in the records indefinitely, allowing field personnel to retain prior history of past service issues at a residence. This allows them to act in a cost effective manner when considering repair or replacement of equipment or lines at a premise. In addition, CC&B automates field activities to the field. A background process makes key decisions about assignments and timing. CC&B automates field activity dispatching and allows for uploading and downloading to hand-held devices. The system allows the field operators to complete field activities in a live environment so that CSR's (customer service representatives) have the information available to them as soon as the order is completed. In this regard, WSCK has deployed "tough books" in each field vehicle

Additionally, CC&B system has several other improvements when compared to the legacy system. For instance:

- The billing estimation function is improved. It now includes a 3 tier process that incorporates:
    - Customer history from last year same period.
    - Customer history for last 3-6 months.
    - Trend data from the customer's trend area (CIS Division) and trend class (Residential and Commercial)

- The system provides for the automatic proration of billings based on number of days in read period or bill period.

- The system allows for the automated dispatching of Field Orders/Field Activities to Operations Staff for quicker response.

- More efficient means of billing customers who have one account, but more than one premises.

- More history for viewing by Customer Service to answer questions from customers.
    - History of reads
        - Legacy system held only the last 12 readings
    - History of billings
        - Legacy system held only the last 12 billings

- Field Operations now have access to customer premise and service point information as well as meters and meter readings.

- Account numbers stay with the customer for life. This gives the Company the ability to track a customer from location to location.
    - This gives the company the ability to track a customer from location to location.
    - With the random generated account numbers, a reduction in misapplied payments will be drastically reduced.

- More information displayed on one screen for customer service to assist customers. The legacy system required moving from one screen to another.

- Automatic Collections and Severance process configured which reduces error from input. Accidentally disconnecting a customer for non-payment will be hard to do.

- Updates to the system are real time.
    - Completion of field activities
    - Payments and adjustments
    - Customer information

- Customers will have the ability to view account using the internet
    - View billing information
    - Update Account information
    -

CC&B is used on a daily basis to look up customer accounts to answer billing questions. Billing issues are identified and resolved immediately before the customer receives their bill. Mail and walk in payments are posted to the customer's account in real time. Field activity reports are created to turn on/shut off water, check for leaks and re-read meters on a daily basis through CC&B. These activities are generated in real time for a quicker response from the field personnel. All corrections or adjustments to a customer's account is entered into CC&B and, again, posted in real time.

Customer Service personnel use CC&B to look up customer's accounts and review meter reads, payment history, consumption history and mailing addresses. All pertinent information is displayed on one screen which helps Customer Service answer questions quickly. New customers are signed up through CC&B. Customers discontinuing their service are also taken care of through CC&B. Payments are posted in real time to a customers account through CC&B.

CC&B was placed into service on June 2, 2008. The total cost of the CC&B system was $7,077,652. $178,715 was allocated to WSCK. (William's prefiled testimony, pages 13-15) The cost of the JDE and CC&B systems was allocated to

WSCK using ERCs (equivalent residential connections). The allocation of Project Phoenix costs that was prepared for this case utilized the WSCK ERCs at the end of the test year in comparison to the total ERCs for UI. Dividing the WSCK ERCs by the total ERCs resulted in a percentage value that was then multiplied by the total investment in JDE. (William's HT 11:04)

The allocation of Project Phoenix and CC&B were allocated in the same manner as all other common costs. All UI allocations are based on the use of ERCs. (Georgiev HT 12:20) As previously mentioned, WSCK is a wholly owned subsidiary of Utilities, Inc. Utilities, Inc. also wholly owns over 90 other subsidiaries in 15 different states. Utilities, Inc. also wholly owns Water Service Corporation, which is a company that manages the water and sewer operations for Utilities, Inc. subsidiaries. WSC operates without profit. Costs that are not directly assignable to a specific subsidiary are booked to WSC and are allocated to the Utilities, Inc. subsidiaries at year end, based on the basis of the proportion of active Equivalent Residential Customers ("ERCs") served by the Operating Company to the total number of active ERCs served by the Parent and its affiliates. The WSC Service agreement is filed with the Application.

The methodology of allocation went into effect first quarter of 2008. (The Company recalculated the allocations to remove sewer customers in Clinton which WSCK does not own. Therefore, the allocations had to be recalculated based on the Middlesboro water distribution customers and the Clinton water customers only).

The Attorney General raised a question about the use of ERC's and suggested that it would be more appropriate to use actual customer count. There would be no benefit to that suggestion. First, it would require that a separate accounting and allocation system be created and maintained for WSCK. That would only add cost to the process, not save cost. Second, the Kentucky customers would not benefit from the allocation of costs among larger companies that have more commercial and industrial customers. Those larger customers are the equivalent of several residential customers, which results in an additional share of the total company costs being allocated.

The Virginia State Corporation Commission in an order dated August 18, 2009 in the "Application of Massanutten Public Service Corporation, Case No. PUE 2008-00040, page 3 (filed with Hearing Responses on August 26th) said of the adoption of the ERC: "With the new computer system, it is anticipated that the only allocation method that will be used is ERCs. According to the Applicant, the continued use of CEs (customer equivalants) as MPSC's allocation method **would result in increased costs for MPSC."**

The Attorney General also asked about the ability of WSCK reviewing and rejecting certain allocations that he believes do not apply directly to Kentucky operations. Such a review and rejection power is not included in the Allocation Manual. The reason is obvious. If each operating unit of UI could reject allocation of expenses believed to be unrelated to its operations, then the system of allocations would be self defeating. Each operating company benefits from the economies of scale of UI and each must share in the costs.

There was also a question about the recovery of the cost of these systems within the first year of the implementation of the proposed rates. Ms. Georgiev explained that the $546,000 costs of the Phoenix Project are being amortized over eight years, not one, and that the average impact on the customers is about $8 per year. (Georgiev HT, 12:11)

V. Tariff Changes

WSCK is also proposing several tariff changes to shift costs of certain specific fees to the customers that actually cause those costs to be incurred by the Company. (William's HT 11:14) All changes to the tariffs are all included in the proposed tariffs filed as exhibit 2 to the Application and are highlighted in red text.

- A new section has been added for a tap fee of $1,434.00 for 1 inch and smaller connections. Larger taps will be billed to the customer at the contractor cost for material and labor. A fee calculation sheet is attached.
- The billing procedures have been modified to allow for electronic billing and payment if a customer chooses.
- The deposit provision has been changed to impose a uniform deposit on all residential and small commercial customers that is equal to 2/12ths of the average residential bill, or 3/12ths or 4/12ths if the billing cycle is not monthly.
- A provision has been added to allow cut off of water service to a city of Clinton sewer customer, if the city requests that action.
- The cross connection policy has been modified to more fully explain the customer's responsibilities.
- A new billing procedure has been added to require a customer who has two check payments returned for non-sufficient funds to make all future payments in cash.
- Finally, the existing water extension agreement is being replaced with two new agreements – one for extension to individual customers and one for extension made by developers.

The service reconnection fee and other service fees are increased from $20.00 to 27.00. A new NSF fee of $15.00 is added as is a New Customer Set Up fee of $27.00.

Additionally, the Meter Test fee of $15.00 is increased to $20.00 for residential meters and cost for larger meters. A Tampering fee of $27.00 is also being established.

These proposed increases are reasonable and move the fees closer to the company's actual cost. (Lashua HT 2:03)

Mr. Lashua testified that the proposed charges are based on the Company's estimated costs of labor, administrative, and related costs. (Lashua HT 2:04) The Company provided the calculations of those costs with the Application.

VI. Corrections/clarifications to hearing testimony

After reviewing the testimony provided at the hearing, WSCK determined that several responses to questions were inaccurate or incomplete.

1) Mr. Lashua responded that credit card billing is not currently being allowed by WSCK. However, customers are allowed to pay by credit card. There is a payment processing fee of $3.00 imposed by the credit card processing agent, but WSCK does not collect any additional fee and does not benefit from that collection fee. A copy of the back page of the customer bill is attached which shows the payment options and which went into place with the new Customer Care and Billing program initiated in June 2008. This is standard language on all bills in all areas. Only a very few WSCK customers have actually used this method.

2) Mr. Lashua responded incorrectly when asked about the contract operations for the Clinton sewer system. The operation fee is specified in the agreement and calculated at $15,000 annually [plus CPI inflation since agreement inception] and 3% of gross revenues plus costs.

3) Ms. Georgiev testified that federal taxes are allocated. Federal taxes are not allocated. They are calculated for each company based on that company's income/expense items. However, the % that was used is fixed - 35 % - and that percentage is determined based the consolidated federal tax return that incorporates all subdivisions. State taxes are strictly state related.

4) Questions were asked about two invoices. One was for a 10/17/07 charge to Del Frisco's in Orlando Florida for $916.38. The expense reimbursement did not show that the meal was for a total of 20 people and was for employee recognition for Project Phoenix work. UI has a large operations office in Altamonte Springs Florida just outside Orlando. This should be appropriately distributed across all customers in the Utilities Inc. group. An invoice for Las

Vegas was also questioned. Utilities, Inc. has an operations office in Pahrump, Nevada which is about 60 miles from Las Vegas and the Company representatives were there for routine course of business matters.

5) Mr. Williams was asked about unregulated operations of UI. There are two unregulated subsidiaries of UI: Bio Tech Inc. located in South Carolina and Acme water Supply and Management Company located in Florida. Each company was allocated a portion of the Project Phoenix costs.

6) Mr. Williams correctly testified that the AIG ownership percentage is 12%.

WSCK believes that the evidence presented in its Application, data responses and hearing testimony provide overwhelming justification for its proposed rate adjustment. Customers are getting the value of water priced at about $0.01per gallon (Lashua HT 12:18), while the Company has operated below its required return on investment for the last several years. Its customers have benefited from service at below cost. However, the Company cannot continue to absorb the increased costs of operations, many of which are beyond its control. With the increasing demands for more stringent treatment standards, increased costs for labor, chemicals, electricity and other purchased goods and services, WSCK must increase its rates (Lashua HT 2:17).

The Company understands the customers' resistance to the increase, but it is obligated to continue to provide the highest quality water and customer service. To do that it must cover the increasing costs of operations. It also must operate efficiently enough and at a level of financial stability to attract investors. Without continued investment in new plant, improved operations and repairs and replacements of existing facilities, the Company' ability to provide the level of service the customers have become accustomed to will suffer. The only way for the Company to accomplish these objectives is through a rate increase.

For these reasons, the Company requests that it be granted the rates and revenue increase proposed in its Application.

Submitted by:
John N. Hughes
124 West Todd St.
Frankfort, KY 40601

Attorney for Water Service Corporation of Kentucky

Certificate of Service:

A copy of this Brief was delivered to parties of record, the 31st day of August, 2009.

John N. Hughes

Important Information to Help Serve You Better

Security	To help us maintain the security surrounding your drinking water system, please call your local office listed on the front of your bill and the police if you notice any suspicious activity.
Service	If you experience a water or wastewater emergency, please call the Customer Service number listed on the front of your bill. Service operators are on-call 24 hours a day, 7 days a week. Information, including how your water meter is read, can be found at **www.uiwater.com** or you may call your local office number listed on the front of your bill.
Contact Information	Please be sure to let us know if your telephone number changes. We strive to offer efficient and responsible customer service. In the event that we encounter a problem in your water or wastewater system, we will need to contact you. To update your account information, you may call the Customer Service number listed on the front of your bill, or you may visit our website at **www.uiwater.com** or use the form below.

Conservation Tips

Repair dripping faucets and leaking toilets. Dripping faucets waste about 2,000 gallons of water each year. Leaking toilets waste as much as 200 gallons each day or 73,000 gallons per year.

A normal shower uses about 20-30 gallons of water. Take shorter showers. Install a showerhead with an aerator that will mix air with your water so that you will be using less. Showerheads with a turn-off valve are available so that you may turn off the water while soaping or shampooing without changing the temperature of the water.

It takes 3-7 gallons of water to flush a toilet. Consider replacing an older toilet with a water-efficient model that uses 1.6 gallons per flush. You can also install a dam in your toilet, which will displace some water so that less will be used per flush. Fill a plastic soap or milk bottle with water and place it in the tank away from toilet mechanism to function as a water saving device. Don't use the toilet as a trash disposal for tissue, gum wrappers, cigarettes, etc.

Payment Methods

Automatic Payments	Why write a check and pay postage? Make your payments automatically with Auto Pay. Contact us at the Customer Service number listed on the front of your bill or visit **www.uiwater.com** to download the Automatic Bank Drafting Authorization form.
By Internet	Pay your bill online by visiting **www.paybyinternet.com** and indicate that you are making a payment to Utilities Inc. A convenience fee will be charged for using this option. Please be sure to have your utility account number ready.
By Phone	Make payments using your checking account, debit or credit card by calling **1-877-527-7852.** A convenience fee will be charged for using this option. Please be sure to have your utility account number ready.
By Mail	Use the enclosed envelope to mail your payment.

Change of Address and Phone Information

Complete the information below with your address and phone corrections and return with your payment

Name ____________________
Please Print

Street ____________________

City ________ State ________ Zip ________

Home Phone ________ Work Phone ________

Email Address ____________________