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October 5, 2006

RECEIVED

OCT 05 2006

PUBLIC SERVICE
COMMISSION

Beth O'Donnell
Executive Director
Public Service Commission
211 Sower Blvd.
Frankfort, KY 40601

Re: Case No. 2005-00325

Dear Beth:

In response to recent questions about certain rates proposed for Clinton and Middlesboro in this application, Water Service Corporation of Kentucky (WSCK) will attempt to clarify the issues. In its application, WSCK proposed to include in its tariffs certain flat rates. All of the affected rates are for fire protection or sprinkler systems. Some of those rates appear to not be specifically set out in the current tariff. Because WSCK became aware of this discrepancy in the preparation of the rate application, it included the omitted rates in the proposed tariff.

Based on information that WSCK could obtain from the local office management, the rates in question have been charged for many years. No explanation for the lack of inclusion in the tariff could be determined. However, a review of the last rate case filing for Clinton and Middlesboro provides some information that seems relevant. The attached documents from Case No. 89-340, "The Application of Aqua Corporation for an Adjustment of Rates for Middlesboro and Clinton, Kentucky" include several references to public and private fire protection service and sprinkler service. In fact the monthly rate for public hydrants is \$3.33 per month, the same rate that is currently being charged for that service and the same rate that is included in the WSCK application as the "current rate" for that service.

In the documents from Case 89-340, there is also information about a \$15.00 per month private fire protection fee, the same fee being charged by Clinton and Middlesboro for commercial and industrial sprinkler services. It appears that while Aqua was charging for the services listed in WSCK's application, it did not specifically identify each specific

customer classification being charged that fee, rather, the information from Case 89-340 seems to lump a number of unspecified customers into groups: "Public fire protection"; Private fire protection"; and "Miscellaneous". The revenue from these customers was recognized in the calculation of the revenue requirement allowed in that case. Obviously, the issue of hydrants and public and private fire protection was included in the review of that case.

Because WSCK cannot trace the origination of the customer classifications listed in the tariff, it can only assume that Aqua Corporation billed customers falling generally into the fire protection classification under the categories listed in WSCK's application. WSCK cannot determine how those rates were calculated. It only has the customer information from current billing records.

After reviewing the available information, it appears that the issue of flat rate fire protection and hydrant fees has been disclosed in prior cases. Those fees have been included in rate filings and in some instances in tariffs and certainly have been charged for many years. The flat rate nature of the fees may be related to a provision in the AQUA/KWS tariff (the tariff in effect prior to the filing of this rate case). On page 7, under "Rules and Regulations", there is a statement that "**except for fire** and special temporary services" all service will be on a metered basis. If the fire protection is the exception to that rule, then obviously, the rate would have to be a flat rate, just as it is and has been for many years. While there appears to be no clear answer to why the fees in question were not adequately tariffed, it seems apparent that they were known to be included in the rate filings of the predecessor to WSCK.

Because WSCK only became aware of the lack of specific reference to these fees in the tariffs when it began preparing its rate application, it should not bear the brunt of some past failure of a predecessor owner for the lack of clarity of the tariff classifications. Any refund or penalty assessed against WSCK would be unrelated to rates collected by it and require the payment of a refund or penalty from funds it did not collect and does not have. WSCK should not be the surrogate for the party actually responsible for any alleged violation of the statutes and regulations.

The effect of disallowing the recovery of these rates will be to provide a number of customers with free service, a practice prohibited by KRS 278.170. These customers have benefited from the availability of the service and been aware for many years of the fees associated with the service. The customers affected by these fees were given notice of the proposed rate increases and none objected. Any lost revenue resulting from the disallowance of these fees will be subsidized by other customers in the calculation of the agreed upon revenue requirement.

WSCK did what it believed to be the correct action. It included in the tariffs proposed in this application the actual rates being charged. It placed the commission and the customers on notice of the rates. It believed it had adequately proposed to correct the prior error. If those rates are rejected, WSCK will lose revenue simply because of the error of the prior owner of the company. Additionally, the affected customers will have a

fee eliminated from their bill until WSCK files another rate application, which again will propose those same rates.

While KRS 278.160 says no utility may charge a rate that is not included in its schedules, WSCK believes that because it has included the fees in question in its proposed tariffs, that it will not be charging an improper fee on a going forward basis. There is also a question of whether the fees have actually been included in past tariffs. This issue of the non-tariffed fees did not come to full light until after the execution of the Settlement Agreement in this case. WSCK was not aware that the fees in question now were subject to disallowance because of the lack of prior inclusion in the tariff. It serves no purpose to disallow the fees. The affected customers are no more entitled to free service due to a distant mistake on the part of a previous owner than WSCK is subject to the loss of revenue for that same mistake. WSCK has indicated that the settlement rates do not have to include any increase in the flat fees at issue. The affected customers will simply continue to pay the fee that they have for many years. By maintaining the status quo with these customers, WSCK can receive the revenue all parties agreed it needs to operate, as reflected in the Settlement Agreement. If the revenue from the disputed fees is eliminated from WSCK's revenue, it will probably be forced to seek another rate increase in a much shorter time than otherwise expected.

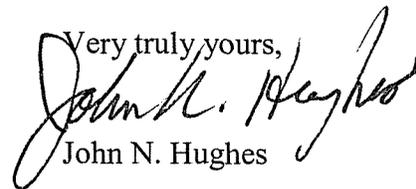
Unlike other situations where a utility willfully collects an untariffed rate, or has control over the inclusion or exclusion of a rate, WSCK neither willfully nor knowingly collected an untariffed fee and had no control over the actions of the prior owner. It simply billed the same fees that had been billed for years by the prior owner. Only after investigating the rates as part of the preparation of the rate application, did WSCK learn of the issue. It took action to correct it. In fact, there is evidence in the prior filings of the predecessor company that these rates were contemplated and reflected to a certain extent in prior tariffs.

In two similar situations, the commission did not require refunds of the questioned rates. Case No. 2004-00138, Notice and Proposed Tariff of Transworld Network, Corp, Order of October 19, 2005, the commission found that Transworld conducted business in Kentucky without authorization. In the order the commission notes that Transworld only discovered that it was operating without authorization when it filed its tariffs and application to operate in Kentucky. In determining that no refund of any prior unauthorized rate was appropriate, the commission stated: "Transworld admitted its prior non-compliance, expended resources by attending an informal conference, acknowledged the significance of its oversight by offering a settlement, and has continued to be responsive and forthright with Staff." (Order of October 19, 2005, page 3). The same can be said of WSCK.

In Case No. 97.043, "Phoenix Network, Inc. Settlement offer for the Acquisition of Teletrend Communications, Inc in violation of KRS 278.020(4) and (5)", order of April 29, 1997, the commission did not require a refund of a prior owner's rates that had not been tariffed. Teletrend failed to file tariffs. Subsequently, Phoenix acquired Teletrend. After an investigation, the commission allowed Phoenix to operate without

refund of prior rates. Phoenix asserted in its response to the commission that it believed all regulatory requirements had been previously met and that its customers had received the same rates and services under the same terms and conditions as they did prior to the acquisition. The same can be said of WSKC.

Because some of the rates are actually referenced in prior tariffs and the revenue from the fess is included in the revenue requirement, the issue of the validity of the rates is at best confused. WSKC proposes to recognize the flat rates as set forth in the proposed tariff as current, valid rates, but without any increase as part of this rate proceeding. WSKC remains willing to work with the staff and Attorney General to resolve any remaining questions about the tariff issue, but believes that there is no basis to reject the proposed tariffs simply because of some lack of regulatory compliance on the part of the prior owners of the company.

Very truly yours,

John N. Hughes

Attorney for Water
Service Corporation
of Kentucky

cc: David Spenard

CLASSIFICATION OF SERVICE

MUNICIPAL FIRE HYDRANTS

RAT
PER U

AVAILABILITY

Available by contract within the cities and counties of the communities served upon written notification resulting from appropriate resolution by the governing body. Installation to be made only on Kentucky Water Service Company, Inc.'s distribution system and only on mains of sufficient size and/or capacity.

In unincorporated areas and sparsely populated areas, the minimum distance between hydrants shall be 1,000 feet.

No main extensions shall be required for fire hydrant installation only, except by the Company's Main Extension Agreement as approved per these rules and regulations.

RATES

Somerset	First 60 hydrants	@	\$50.00	each per year
Pulaski County	Excess 60 hydrants	@	45.00	each per year
Middlesboro	All Hydrants	@	40.00	each per year
Bell County				
Clinton	All Hydrants	@	40.00	each per year
Hickman County				

#26 Question #26 Public Hydrants.
 Clinton has 53 hydrants @ 40.00/yr ÷ 12 = 3.33333/month
 Middlesboro has 274 @ 40.00/yr ÷ 12 = 3.33333/month

DATE OF ISSUE... April 26 1978
 month day year

DATE EFFECTIVE April 26, 1978 - December 22, 1947
 month day year

ISSUED BY L. B. Dodson Vice President-Gen. Mgr. 201 N. M
 Name of officer title Address Somerset

For All Communities Served
Community, Town or City

P. S. C. No. 2

~~Revised~~ SHEET No. 2

Cancelling P. S. C. No. 1

~~Revised~~ SHEET No. 1

KENTUCKY WATER SERVICE COMPANY, INCORPORATED
Name or Issuing Corporation

CLASSIFICATION OF SERVICE

**RATE
PER UNIT**

PRIVATE FIRE PROTECTION SERVICE

AVAILABILITY

Available for private fire hydrants and sprinkler systems in all communities served by the company where adequate distribution mains are already installed and in service.

Each hydrant or sprinkler system connected to either company main or customer owned main will be considered as a separate unit and will be billed as such. Customers with sprinkler systems and/or hydrants served either from their own distribution system or directly from company mains will be required to install a detector check meter.

RATE

- 4" connection \$ 7.50 each per month
- 6" connection \$ 15.00 each per month

CHECKED
PUBLIC SERVICE COMMISSION
JAN 14 1963
by *CHP*
ENGINEERING DIVISION

FILED
JAN 15 1964
PUBLIC SERVICE COMMISSION

DATE OF ISSUE January 1954
month day year

DATE EFFECTIVE November 9, 1949
month day year

ISSUED BY W.E. Bayless Vice President Somerset, Kentucky
name of officer title address

8-92

For Communities Served (Listed below)
 Community, Town

P. S. C. No. 2

Revised { Original } SHEET No. 2
 { Revised }

Kentucky Water Service Company, Inc.
 Name of Issuing Corporation

Cancelling P. S. C. No. 1

Original { Original } SHEET No. 1
 { Revised }

CLASSIFICATION OF SERVICE

MUNICIPAL FIRE HYDRANTS

RATE PER UNIT

AVAILABILITY

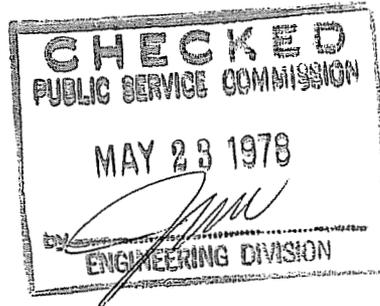
Available by contract within the cities and counties of the communities served upon written notification resulting from appropriate resolution by the governing body. Installation to be made only on Kentucky Water Service Company, Inc.'s distribution system and only on mains of sufficient size and/or capacity.

In unincorporated areas and sparsely populated areas, the minimum distance between hydrants shall be 1,000 feet.

No main extensions shall be required for fire hydrants installation only, except by the Company's Main Extension Agreement as approved per these rules and regulations.

RATES

Somerset	First 60 hydrants	@	\$50.00 each per year
Pulaski County	Excess 60 hydrants	@	45.00 each per year
Middlesboro	All Hydrants	@	40.00 each per year
Bell County			
Clinton	All Hydrants	@	40.00 each per year
Hickman County			



DATE OF ISSUE April 26 1978
 month day year

DATE EFFECTIVE April 26, 1978 - Wording
December 22, 1947 - Rates
 month day year

ISSUED BY L. B. Dodson Vice President-Gen. Mgr. 201 N. Main St.
 Name of officer Title

THE AQUA CORPORATION - MIDDLESBORO

REVENUES FROM PRESENT AND PROPOSED RATES

BASED ON BILL ANALYSIS FOR TWELVE MONTHS ENDED OCTOBER 31, 1989

PROPOSED RATE

First	1,000	Gallons per month	\$5.80	Minimum
Next	9,000	Gallons per month	2.30	Per 1000 Gallons
Next	15,000	Gallons per month	2.20	Per 1000 Gallons
Next	25,000	Gallons per month	2.00	Per 1000 Gallons
Next	50,000	Gallons per month	1.85	Per 1000 Gallons
Over	100,000	Gallons per month	1.70	Per 1000 Gallons

Consumption Block	Cumul Cons.	Block Cons.	Rate	Annual Revenues
Minimum Bills	4,212	7901	\$5.80	\$45,826
0 1,000	59,351	55139.0	5.80	319,806
1,100 10,000	264,105	204753.6	2.30	470,933
10,100 25,000	289,803	25698.0	2.20	56,536
25,100 50,000	307,836	18033.2	2.00	36,066
50,100 100,000	326,016	18179.8	1.85	33,633
Over 100,000	381,060	55044.0	1.70	93,575
Subtotal				\$1,056,375
Prorated				\$11,977
Large Minimums				20,465
Public Fire Protection				11,047
Private Fire Protection				5,530
Sprinklers				5,452
Allowances				(2,358)
Reconnection Chg.				1,158
Service Charges				158
Middlesboro Sewer				1,604
Analysis Error -0.28%				(3,072)
Total Computed Revenues				1,108,336

THE AQUA CORPORATION - MIDDLESBORO

REVENUES FROM PRESENT AND PROPOSED RATES

BASED ON BILL ANALYSIS FOR TWELVE MONTHS ENDED OCTOBER 31, 1989

PRESENT RATES

First	1,000 Gallons per month	\$5.20 Minimum
Next	9,000 Gallons per month	2.05 Per 1000 Gallons
Next	15,000 Gallons per month	1.95 Per 1000 Gallons
Next	25,000 Gallons per month	1.80 Per 1000 Gallons
Next	50,000 Gallons per month	1.65 Per 1000 Gallons
Over	100,000 Gallons per month	1.50 Per 1000 Gallons

Consumption Block	Cumul Cons.	Block Cons.		Rate	Annual Revenues
Minimum Bills	4,212	7901	Minimum Bills	\$5.20	\$41,085
0 1,000	59351.0	55139.0	X	5.20	286,723
1,100 10,000	264104.6	204753.6	X	2.05	419,745
10,100 25,000	289802.6	25698.0	X	1.95	50,111
25,100 50,000	307835.8	18033.2	X	1.80	32,460
50,100 100,000	326015.6	18179.8	X	1.65	29,997
Over 100,000	381059.6	55044.0	X	1.50	82,566
Subtotal					\$942,687
Prorated					\$10,694
Large Minimums					18,272
Public Fire Protection					11,047
Private Fire Protection					5,530
Sprinklers					5,452
Allowances					(2,105)
Reconnection Chg.					1,158
Service Charges					158
Middlesboro Sewer					1,432
Analysis Error -0.28%					(2,741)
Total Computed Revenues					\$991,584
Total Per Books					\$991,584

Format 7b
Middletown

AQUA CORPORATION

Test Year Nov 88 thru Oct. 1989

Case No. 89-340

Item No. 6b

Analysis of Customers and Revenue

	1st Month	2nd Month	3rd Month	4th Month	5th Month	6th Month	7th Month	8th Month	9th Month	10th Month	11th Month	12th Month
<u>Number of Customers</u>												
Residential	4594	4585	4567	4567	4577	4577	4594	4605	4597	4614	4601	
Commercial	710	709	702	701	703	702	709	714	710	721	723	
Industrial	20	20	19	19	19	19	19	19	18	18	18	
Fire Service	35	35	35	35	35	35	34	34	35	34	34	
Other	33	30	30	30	30	29	29	29	29	34	39	
Tot. No. of Customers	5392	5379	5353	5352	5364	5360	5385	5397	5388	5421	5415	
<u>Water Revenue</u> Rounded to nearest dollar												
Residential	\$53,357	55,301	59,110	52,417	49,788	57,514	54,583	58,331	57,936	57,478	59,752	
Commercial	17,319	17,363	17,936	15,937	15,616	18,445	17,462	19,804	20,229	19,495	21,109	
Industrial	4,623	4,392	5,020	3,996	3,589	4,498	2,876	3,093	3,430	2,919	3,552	
Fire Service	1,825	1,825	1,825	1,825	1,825	1,825	1,825	1,825	1,825	1,825	1,825	
Other	3,299	3,353	3,490	2,976	2,912	3,254	3,364	3,503	2,885	2,973	3,395	
Total Water Revenue	\$80,423	82,234	87,381	77,152	73,729	85,535	80,096	86,541	86,289	84,686	89,627	
Allowances	\$ 475	203	150	278	87	77	56	192	36	326	132	

RECEIVED
 APR 16 1990
 PUBLIC SERVICE
 COMMISSION

THE AQUA CORPORATION
 MONTHLY STATEMENT OF OPERATIONS

ESBORO OPERATIONS

	NOV. 1988	DEC. 1988	JAN. 1989	FEB. 1989	MAR. 1989	APR. 1989	MAY 1989	JUN. 1989	JUL. 1989	AUG. 1989	SEP. 1989	OCT. 1989
OPERATING REVENUES:												
METERED SALES-RESIDENTIAL	\$53,304	\$55,359	\$59,285	\$52,522	\$51,024	\$57,865	\$54,814	\$58,420	\$60,305	\$57,482	\$59,854	\$53,459
METERED SALES-COMMERCIAL	17,210	17,298	17,828	15,825	15,555	18,402	17,422	19,750	20,211	19,445	21,084	18,159
METERED SALES-INDUSTRIAL	4,623	4,392	5,020	3,996	3,589	4,498	2,876	3,093	3,430	2,919	3,552	3,297
PUBLIC FIRE PROTECTION	903	903	903	903	903	903	903	903	903	913	1,091	913
PRIVATE FIRE PROTECTION	922	922	922	922	922	922	907	907	907	907	907	918
OTHER SALES TO PUB. AUTH.	3,145	3,353	3,490	2,976	2,912	3,254	3,364	3,503	2,885	2,971	3,395	3,177
TOTAL OPERATING REVENUES	\$80,107	\$82,227	\$87,448	\$77,144	\$74,905	\$85,844	\$80,286	\$86,576	\$88,641	\$84,637	\$89,883	\$79,923
OPERATING EXPENSES:												
SOURCE OF SUPPLY - OPERATIONS	\$12,013	\$13,027	\$11,203	\$12,186	\$1,908	\$12,262	\$18,536	\$3,842	\$21,918	\$987	\$11,476	\$11,018
WATER TREATMENT OPERATIONS	6,170	5,264	2,664	4,925	4,793	5,003	6,169	5,977	11,242	3,458	6,777	7,507
WATER TREATMENT - MAINTENANCE	59	293	129	3	0	0	94	15	157	0	175	0
TRANS. AND DISTR. - OPERATIONS	2,964	1,512	722	2,323	1,071	2,559	2,159	2,218	2,421	1,126	1,410	2,652
TRANS. AND DISTR. - MAINTENANCE	7,373	7,066	7,851	9,107	5,519	8,451	6,227	3,626	11,242	1,856	6,198	3,429
CUSTOMER ACCOUNTS	13,980	15,155	4,956	15,527	11,210	14,061	17,363	13,946	19,364	9,678	11,725	13,013
ADMINISTRATIVE AND GENERAL	6,992	7,984	7,209	6,825	7,519	6,418	7,007	9,104	(10,934)	7,962	14,890	16,155
DEPRECIATION AND AMORTIZATION	7,069	7,069	7,069	7,069	7,069	7,069	7,249	7,087	15,729	7,087	7,087	7,087
TAXES OTHER THAN INCOME	449	3,394	2,686	2,835	3,834	3,601	4,560	5,020	6,327	6,148	3,576	3,854
TOTAL OPERATING EXPENSES	\$57,069	\$60,764	\$44,489	\$60,800	\$42,923	\$59,424	\$89,364	\$50,835	\$77,466	\$38,302	\$63,224	\$64,761
OPERATING INCOME BEFORE INCOME TAXES	\$23,038	\$21,463	\$42,959	\$16,344	\$31,982	\$26,420	(8,078)	\$35,741	\$11,175	\$46,335	\$26,659	\$15,162

THE AQUA CORPORATION

WITNESS: WILLIS JACKSON

CASE NO. 89-340

2ND PSC INFORMATION REQUEST - ITEM NO. 4

ADDITIONAL REVENUES AND EXPENSES

There will be only one new residential customer and one municipal fire hydrant resulting from this addition. The residential customer, based on an average user, is projected to consume approximately 6,045 gallons of water monthly and thereby add \$17.40 of revenues under proposed rates and add \$9.93 in additional cost per month based on an average cost of \$1.64 per 1,000 gallons per month for the Middlesboro system using pro forma operating costs. Net revenues from this customer is projected to be \$7.47 per month or \$89.64 per year, exclusive of depreciation and interest expense which has already been included in pro forma operations, Exhibit 10. The municipal fire hydrant will generate an additional \$40 per year in revenues.