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Mark David Goss  
Chairman

John W. Clay  
Commissioner

June 19, 2007

## PARTIES OF RECORD

Re: Case No. 2006-00403

Attached is a copy of the memorandum which is being filed in the record of the above-referenced case. If you have any comments you would like to make regarding the contents of the informal conference memorandum, please do so within five days of receipt of this letter. If you have any questions, please contact James R. Goff at 502/564-3940, Extension 261.

Sincerely,

A large, stylized handwritten signature in black ink, appearing to read "Beth O'Donnell".

Beth O'Donnell  
Executive Director

Attachment

## INTRA-AGENCY MEMORANDUM

### KENTUCKY PUBLIC SERVICE COMMISSION

**TO:** File: Case No. 2006-00403

**FROM:** Jason Green, Team Leader

**DATE:** June 19, 2007

**RE:** Case No. 2006-00403  
Adjustment of Wholesale Rates of City of Falmouth, Kentucky

On June 15, 2007, an informal teleconference was held to discuss the finding and recommendations of the Commission Staff's report issued on May 11, 2007. Those in attendance were:

Eddie Beavers, PSC	Henry Watson, Falmouth
Jason Green, PSC	John Weil, Falmouth
Sam Reid, PSC	April Defalco, Falmouth
James Rice, PSC	Ilean Koettel, Falmouth
Scott Lawless, PSC	Sheri Wright, East Pendleton
J.R. Goff, PSC	Wayne Lonaker, East Pendleton
William Jones, Pendleton	

At the conference, representatives of the city of Falmouth questioned the Commission's jurisdiction over Falmouth's wholesale tariff. They further questioned Staff's application of the historical test-year approach as provided for in administrative regulation 807 KAR 5:001, Section 10. Staff explained that, by matter of law, the Commission regulates Falmouth's wholesale tariff and the historical test-year method is the most common method used in applications brought before the Commission. Staff briefly discussed forecasted test years, as provided for in 807 KAR 5:001, Section 10, and the filing requirements of such an application.

Falmouth made objections to three findings and recommendations included in the Commission Staff's report. Falmouth objected to: (1) the level of employees included by Staff; (2) the *pro forma* chemical expense included by Staff; and (3) the depreciable lives used by Staff.

In its application, Falmouth calculated *pro forma* salaries and wages allocable to its water division based upon 17 employees. The employees are listed in Falmouth's response to the Commission's September 22, 2006 request for information at Items 9 and 25, page 16 of 26. The employees listed were employed by Falmouth at the time GRW performed field work to prepare its cost-of-service study. The original date of the study was March 2006, but it was revised to August 2006.

To prepare its report, Staff began field work on January 16, 2007. During Staff's field work, Ilean Koettel, Deputy Clerk, and William Todd Ramsey, Operations Manager, identified 14 employees employed by Falmouth at that time who performed services on behalf of Falmouth's water division. It was upon this information that Staff based its calculation of *pro forma* wages.

At the conference, Falmouth stated four names that were not included in Staff's calculation: Greg Baker, Ina Lawson, Conrad Rueb, and Hank Jenkins. These four employees are listed in Item 9 of Falmouth's response to the Commission's September 22, 2006 information request. At the conference, Ms. Koettel confirmed that Greg Baker and Ina Lawson were no longer employed by Falmouth. Conrad Rueb and Hank Jenkins are listed as Wastewater Treatment Plant Operators in Item 9 and were not identified as performing work for the water division by Ms. Koettel and Mr. Ramsey during Staff's field work.

Falmouth stated that Staff's *pro forma* chemical expense did not account for an increase in chemical costs resulting from the addition of a carbon feeder in 2006. Staff was not aware of this change in Falmouth's water treatment process until the conference. Falmouth's requested *pro forma* operating statement is shown at Item 25, page 15 of 26, of Falmouth's response to the Commission's September 22, 2006, information request. On this statement, test-year chemical expense is reported at \$75,000 with no proposed adjustment.

Staff agreed that an adjustment should be made to test-year chemical expense if Falmouth can show that the change in the treatment process was necessary and any adjustment is known and measurable. To meet the known and measurable criteria, Staff explained that Falmouth could calculate chemical costs per 1,000 gallons of water treated before and after the change in treatment process and apply the difference to test-year gallons treated.

Falmouth generally disagreed with the depreciable lives used by Staff and specifically discussed the lives Staff assigned to meters. Staff explained that, in the absence of a depreciation study, it assigns the middle of the life range recommended by the National Association of Regulatory Utility Commissioners ("NARUC") when establishing depreciable lives for utility assets. The NARUC-recommended range for meters is 35 to 45 years. Staff assigned a life of 40 years to all meters.

Beginning in October 2003, Falmouth spent \$85,148 replacing all meters in its system. It requested recovery of \$10,000 per year for full recovery in 8.5 years. Staff's depreciation adjustment allowed for recovery of \$1,360 annually. Falmouth stated that Staff's annual recovery was unreasonable, as it resulted from unrealistically long useful lives. Falmouth's engineer went on to state that, in instances of other cities, larger meters are sometimes replaced after just two years of service.

Staff maintained its position that Falmouth will not replace all meters every 8.5 years. Generally, the meters replaced beginning in October 2003 had been in service as far back as anybody at Falmouth could remember. The NARUC-recommended life range is 35 to 45 years. Also, the average meter life in the depreciation studies of other water entities previously presented to the Commission is generally 40 years. In those studies, where larger meters were separated from smaller meters, the larger meter's average service life was 40 years.

Mr. Watson questioned the need for the informal conference scheduled on June 19, 2007 at the Commission's offices. Mr. Goff suggested keeping the meeting scheduled as an opportunity to finalize an agreement in the event the parties were able to work out a settlement of the issues. He further stated that the meeting could be canceled at a later time if the parties requested.

The meeting was adjourned.

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