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October 23, 2006

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David Edward Spenard, Esq.
Office of the Attorney General
Utility & Rate Intervention Division
1024 Capital Center Drive
Suite 200
Frankfort, Kentucky 40601-8204

Re: Case No. 2006-00191
Henry County Water District No. 2

Gentlemen:

The enclosed memorandum has been filed in the record of the above-referenced case. Any comments regarding this memorandum's contents should be submitted to the Commission within five days of receipt of this letter. Any questions regarding this memorandum should be directed to Gerald Wuetcher, Deputy General Counsel, at (502) 564-3940, Extension 259.

Sincerely,

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

Beth O'Donnell
Executive Director

gw
Enclosure
cc: Parties of Record

INTRA-AGENCY MEMORANDUM

KENTUCKY PUBLIC SERVICE COMMISSION

TO: Case File No. 2006-00191

FROM: Gerald Wuetcher
Deputy General Counsel

DATE: October 19, 2006

RE: Conference of October 9, 2006

On October 9, 2006, the Commission held a conference in this case in the Commission's offices in Frankfort, Kentucky. Present were:

David Spenard	-	Office of Attorney General
Barry Baxter	-	Henry County Water District No. 2
Tom Green	-	Henry County Water District No. 2
Dan Shoemaker	-	Henry County Water District No. 2
Jimmy Simpson	-	Henry County Water District No. 2
Eddie Beavers	-	Commission Staff
Scott Lawless	-	Commission Staff
James Rice	-	Commission Staff
Sam Reid, Jr.	-	Commission Staff
Gerald Wuetcher	-	Commission Staff

Henry County Water District No. 2 ("Henry District") requested the informal conference. By notice of September 1, 2006, Commission Staff scheduled this conference.

Beginning the conference, Mr. Wuetcher stated that Commission Staff would prepare minutes of the conference for the case record, that a copy of these minutes would be provided to all parties, and that all parties would be given an opportunity to submit written comments upon those minutes.

Mr. Baxter noted Henry District's objection to the timing of the informal conference. He stated that the water district would have preferred for the conference to have been held before Commission Staff's First Set of Interrogatories and Requests for Production of Documents. Henry District was uncertain of the meaning or purpose of certain interrogatories. It also found several interrogatories to be duplicative of those in the Commission's Order of May 22, 2006.

The participants briefly discussed whether the offsetting improvement charge ("OIC") was a system development charge. Mr. Green stated that Henry District regarded the charge as a system development charge, that it comported with the

guidelines set forth in the Commission's final order in Administrative Case No. 375, and that its purpose was to ensure that new customers bore the costs that they imposed upon Henry District's water system. He stated that in Case No. 2001-00393 the Attorney General acknowledged the OIC as a system development charge and that the Commission also gave such recognition.

Mr. Wuetcher noted that the Commission's approach did not appear to support the use of system development charges for the construction of distribution mains. He interpreted the Commission's final order in Administrative Case No. 375 as recognizing the use of system development charges to finance system improvements such as additions to treatment plant capacity, water storage tanks, and transmission mains. He noted that the Commission's Order in Case No. 2001-00393 was silent on the issue and did not characterize the offsetting improvement charge as a system development charge. He further noted that Case No. 2001-00393 was filed with the Commission before Administrative Regulation 807 KAR 5:090 became effective.

Mr. Green noted that the offsetting improvement charge did not recognize any benefits contributed by OIC-funded improvements because, in Henry District's opinion, no OIC-funded improvement provides a benefit to existing customers. He stated that Henry District does not offer grades of service – it provides water service within a set of pressure ranges. If an OIC-funded improvement increases water pressure to existing customers, the increased pressure is not a benefit to those customers since they are still only receiving water service within the required range. The existing customers are receiving exactly what Henry District is authorized to supply – nothing more.

Mr. Lawless inquired whether the ability to provide service to additional customers, and thus generate a greater level of revenues that may be used to reduce rates or limit the need for frequent rate increases, is a benefit of OIC-funded improvements. Mr. Green and Mr. Shoemaker stated that the OIC's designers had not considered the benefits of additional customers when designing the charge. They stated that quantifying such benefits would be difficult.

Mr. Green and Mr. Simpson stated that the OIC was needed to address expected customer growth in Henry District's territory. They noted that suburban development was expanding east from Jefferson County. Currently, water distribution mains are the key facilities needed to meet this growth. Mr. Simpson noted that only 50 percent of Henry District's production and treatment capacity are currently in use. Mr. Green and Mr. Simpson noted that, while the OIC has not generated a significant amount of revenue since its inception, it is in place when the pace of development dramatically increases.

Mr. Green argued that the OIC ensures that all prospective customers are treated equally and fairly. A developer or customer connecting to Henry District's water main distribution system is not unfairly assessed the cost of upsizing water distribution mains merely because he or she is the last developer to develop in an area and earlier developers had already consumed all of the capacity of the area's water distribution mains. The OIC requires all developers, regardless of the existing capacity levels at that time of development, to contribute towards the water distribution main capacity.

Mr. Wuetcher requested a clarification of Henry District's policy regarding depreciation. Mr. Shoemaker explained that Henry District's established rates already contain a component for debt service (principal and interest). This component effectively allows for the recovery of depreciation expense. To include a depreciation expense component in general service rates in addition to the debt service component would require ratepayers to pay twice for utility plant. Henry District funds any major system improvement or replacement (other than distribution mains) through the issuance of debt. Any new treatment or storage facility would be funded through a debt issuance.

Mr. Simpson requested that, should the Commission determine that the OIC should not be extended, it allow the rate to continue in effect pending Henry District's development of a replacement charge to fund water main upsizing. He stated that many land developers, upon learning that the OIC was no longer effective, would immediately seek subdivision of their properties and certification from Henry District as to the availability of water service. They would seek such certification to avoid the payment of any system development charge. Henry District would be unable to impose a system development charge on these developers to recover any appropriate costs related to the provision of water service to their land tracts.

Mr. Baxter inquired as to the next procedural step in this proceeding. Mr. Wuetcher stated that no decision regarding the issuance of another discovery request had been made. Upon completion of the discovery phase of the proceeding, Mr. Wuetcher stated, the Commission could set the matter for hearing. Assuming that the Commission did not on its own motion set the matter for hearing, Mr. Wuetcher expected the Commission to afford all parties the opportunity to request a hearing or to submit written briefs on the OIC. Mr. Baxter stated that Henry District would likely desire at least an opportunity to submit a written brief.

The conference then adjourned.

cc: Parties of Record