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SUBJECT: CASE 2007-00134

This memo will attempt to lay out why the Kentucky-American (KAW) proposal for long term water availability does not seem best for the Bluegrass and why other proposals such as a partnership with the Louisville Water Company (LWC) or a modified Kentucky River plan appear to be superior alternatives.

The Kentucky-American proposal involves acquiring significant amounts of additional water from the Kentucky River. In this scenario, the cost of acquiring untreated water would be quite inexpensive except for the necessity for KAW to build a new water treatment plant to process the water and pipelines to deliver it. And in addition, the Phase II KAW plan calls for a new pipeline to the Ohio River.

The Louisville Water Company proposal involves a partnership with KAW in which both companies would build connecting pipelines to Shelbyville and KAW could purchase an almost unlimited supply of water from LWC. In this case the capital costs of the Lexington-Shelbyville pipeline is estimated to be about half the cost of a new KAW water treatment plant, but the cost to purchase water from LWC would be more expensive than simply pumping raw, untreated water out of the Kentucky River.

Everyone agrees that long term water needs will eventually require access to Ohio River water. What is so ironic is that the LWC solution is both longer-lasting and more cost effective.

What follows below is a cost analysis of both alternatives. LWC has agreed to keeping wholesale water prices constant until 2015 and then to limit annual increases to no more than 2% plus inflation. On the other hand, KAW refuses to agree to any limits on its future rate increases. Thus, costs to the consumer are less certain. That alone should disqualify its plan.

The 25-year analysis indicates that the KAW proposal could cost $60 million more than a partnership with Louisville Water. KAW's present Phase II plan to bring water from the Ohio River at some time in the future would likely cost about $100 million additional dollars. But the cost analysis below, showing a $60 million advantage for the LWC proposal over 25 years does not even add in that future $100 million cost. Adding in that pipeline would simply make the comparison even more advantageous for the LWC proposal.

Even if both scenarios were identical in cost, which they are clearly not, the partnership with Louisville seems more desirable because it provides a longer- lasting solution. While the Kentucky River has a time-limited potential for additional water, the Ohio River does not.

There are those who say that Lexington will need additional water for the 2010 Equestrian Games. That too can be accommodated by LWC through a short-term partnership with Frankfort or with Versailles to obtain more water to Lexington in time for the Games. It is less clear whether KAW could complete its system by then.

There are serious, puzzling questions as to why Kentucky-American is so adamant and virulent about its proposal and why it refuses to entertain even the possibility of a partnership with Louisville Water? It may be because there are two ways for a private water utility to add to profits and since KAW and American Water seem particularly interested in a public offering of its stock, it would add to that possibility with significantly higher earnings.

First, it can boost profits by selling more water. Is this the reason that, in spite of years of urging by the Attorney General's office, KAW has refused to enact any meaningful conservation measures except in emergencies and has refused to mend its excessive leakage of water pipes throughout its system? An effective conservation program and attention to leaking pipes could make a new water supply unnecessary in the short term.

The second way to add to profits is to add to its costs, since KAW is assured a guaranteed return on investment. So to some degree, the more costly its operations, the more profits it will be assured. Is KAW more interested in adding to its costs than serving the community responsibly?

Is this why KAW would prefer to spend at least $60 million more for its own facilities and later, another $100 million more for its pipeline to the Ohio River than to enter into a more cost effective partnership with Louisville?

But don't just take my word for the cost of the KAW plan. The engineering firm of O'Brien and Gere performed a feasibility study for the Bluegrass Area Development District.

In its analysis of a variety of different possible alternatives for long-term water supply to the Bluegrass, the O'Brien and Gere study states that,

> *"purchasing water from the Louisville Water Company was found to be the lowest cost alternative"*

And why does KAW resort to what some would call dubious and questionable statements about its proposal? For example, a December 17 op-ed by Mr. Rowe of KAW said that,

> *"The Lexington-Fayette Urban County Government (LFUCG)...[has] long held that a Kentucky River [KAW] solution is in the best interest of all our customers."*

But that statement is clearly misleading because the Kentucky River solution that the Council endorsed back in 1999 did not involve a new treatment plant or a new pipeline to the Kentucky River, cutting across valuable farmland in Scott and Franklin Counties. The LFUCG has never endorsed the present KAW plan.

In an op-ed in the Winchester Sun, Mr. Rowe stated that,

> *".....The Kentucky River Authority has budgeted funds to install crest gates which will add 1.5 billion gallons of capacity to Pool 3....."*

But I am told that the Kentucky River Authority advises there IS NO MONEY in their budget for Pool 3 crest gates. Doesn't this distress you?

Serious concerns and outright opposition to the KAW proposal are growing. Some have come from Representative Charlie Hoffman, Governor Julian Carroll, the Franklin County Fiscal Court, Frankfort Mayor Bill May, Electric and Water Plant Board of the City of Frankfort, the Frankfort/Franklin County Planning Commission, the city of Simpsonville, the Spencer County Fiscal Court, Envision Franklin County, the Board of Commissioners of the U.S. 60 Water District of Shelby and Franklin Counties and Elizabeth C. Felgendreher of Holly Oak Farm in Midway.

And maybe we shouldn't accept either proposal. Here is what one foremost water expert wrote:

> *"I really don't believe we need to be in such a big hurry to build either pipeline. Here's why:*
>
> *"If we added crest gates to Dams 9 and 10, increased KAW's treatment plant capacity, fixed Lexington's leaky pipes to the national average, modified and installed valves to allow KAW to purchase up to 3 mgd from Versailles and implemented serious conservation and demand side management principles - we*

could hold-off building EITHER pipeline for a long, long time. I have a copy of the GRW report (BWSC Emergency Water Supply Study - Versailles Water System) that shows a 2-3 mgd wholesale purchase from Versailles is possible with a minimal capital investment - approximately $158 K."

In conclusion, whether the Louisville Water proposal or a modified Kentucky River proposal is best, it appears that the present KAW proposal is certainly not in the best interest of water customers and that its higher cost would surely lead to higher than necessary rates. It is hard to imagine why the present KAW proposal is even being considered. I feel a prisoner of KAW and its seeming quest for added investment and added profits and am as perplexed as you as to why the Fayette County Council has remained mute in a matter of utmost importance to its citizens. Nevertheless, please do not approve this high-cost proposal before exploring other, more cost-effective ones.

25 Year Analysis: Kentucky-American Proposal vs. A Partnership with Louisville Water

Kentucky-American Scenario 25 yrs	Present Value@6%
Treatment Plant	160,000,000
Treatment Plant Operations *	106,000,000
Allowed Profit	24,000,000
Total 25 yr cost for KAW Scenario	290,000,000
Louisville Water Company Scenario 25 yrs	Present Value@6%
Pipeline to Shelbyville	88,000,000
Water purchase yrs 1-8 **	43,800,000
Water purchase yrs 9-25 ***	97,800,000
Total 25 yr cost for the Louisville Scenario	229,600,000
Cost savings of the Louisville Proposal	60,400,000

* Plant operations cost starts at $6 million/year and increases by 2.5% each year.

** The quantity of purchased water starts at 6mgd in year 1 and increases to 12.75mgd in year 8 at $1.71 per 1,000 gallons

*** The quantity of purchased water starts at 13.3mgd@ $1.78 per 1,000 gallons in year 9 and increases to 22mgd@ $3.33 in year 25