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Kentucky Public Service Commission
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SUBJECT: TESTIMONY FOR INCLUSION IN CASE 2007-00134

This letter 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 a partnership with the Louisville Water Company (LWC) appears to be a superior alternative.

Nearly all experts seem to agree that long term water needs will eventually require a pipeline to the Ohio River. What is so ironic is that the apparent, best long-term solution seems also to be the most cost effective.

The Kentucky-American proposal involves acquiring significant amounts of additional water from the Kentucky River. In this scenario, the cost of acquiring water would be quite inexpensive except for the necessity for KAW to build a new, expensive water treatment plant and lines to process the water. The Louisville Water Company proposal involves a partnership with KAW in which both companies would build 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 water out of the Kentucky River.

What follows here is a cost analysis of both alternatives. LWC has proposed to keep wholesale water prices to KAW constant until 2015 and then to limit annual increases to no more than 2% plus inflation. The analysis below assumes that water consumption goes from 6mgd in year 1 to 22mgd in year 25 and that the price of purchased water goes from $1.71 per 1,000 gallons in year 1 to $3.33 in year 25.

The 25-year analysis indicates that the KAW proposal could cost $60 million more than a partnership with Louisville Water. Experts seem to agree that at some time in the future, KAW would probably need to build its own pipeline to the Ohio River because the Kentucky River pools would become inadequate. In today's dollars that would likely cost about $100 million. But the cost analysis showing a $60 million advantage for the LWC proposal shown below does not even add in that pipeline cost. Adding in that pipeline would simply make the comparison even more advantageous for the LWC proposal. The additional advantage that

Louisville has in the ability to float municipal bonds is also not factored into their cost advantage.

Even if both scenarios were identical in cost, which they are clearly not, the partnership with Louisville seems more desirable because it provides the longest lasting solution to water for the Bluegrass. While the Kentucky River has a time-limited potential for additional water, the Ohio River does not. There are those who say that we will need additional water for the 2010 Equestrian Games. That too can be accommodated by LWC through a short-term partnership with Frankfort to get more water to Lexington in time for the Games.

People should not put too much faith in these multi-million dollar estimates. Large projects like these normally end up costing significantly more than analysts first believe because, even if the estimates seem on target at the time, planners cannot possibly foresee all the potential potholes and minefields ahead. The enemy of all large projects is uncertainty. The more uncertainty, the greater the chance of significant errors in estimates and, thus, overruns. So another dimension for evaluation is the differences in uncertainty.

Even though many important aspects of the Louisville partnership remain unexplored at this point in time, it still might possess fewer uncertainties. The LWC plans to trench as much as possible along highways which could minimize the problems with wetlands, endangered species and historic site issues. It also might minimize the costly and time-consuming conflicts over easements. The KAW proposal requires cutting through many farms and private areas, especially in Franklin and Scott Counties, where owners are already in open protest.

Serious concerns and outright opposition to the KAW proposal have been growing even before PSC action. The few I know of have already 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. As mentioned earlier, LWC has reduced some uncertainty by placing an upper bound on the wholesale price of water.

The KAW proposal contains two additional, almost monumental uncertainties. When will the time come when the Kentucky River no longer can serve the needs, requiring a $100 million pipeline to the Ohio River? And what will be the result of KAW's proposed financing scheme in which only half of the capital costs for the KAW project would be paid off in the first 25 years and then the last half refinanced 25 years from now. Might KAW face significantly higher interest costs in 25 years? Who knows? These are large risks and tend to make the KAW proposal more uncertain and thus, less desirable.

In conclusion, it appears that large savings accrue to water customers in the Louisville Water scenario with an accompanying potential degree of additional certainty of the estimates. And while the Public Service Commission cannot approve or disapprove the LWC plan, I urge the PSC to reject the present Kentucky-American proposal and ask the company to come back with something more cost effective that would likely be a partnership with Louisville for the long term future of the Bluegrass region.

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 LWC Scenario	229,600,000
Cost savings of LWC 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

Thank you,

Martin B. Solomon