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September 30, 2009

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SEP 30 2009

**PUBLIC SERVICE
COMMISSION**

Mr. Jeff Derouen
Executive Director
Public Service Commission
211 Sower Boulevard
P.O. Box 615
Frankfort, KY 40602-0615

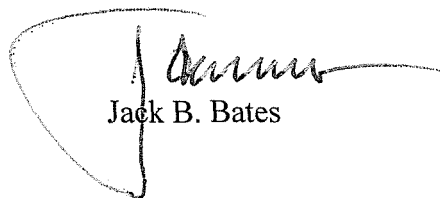
Re: *Tariff Filing of Kentucky-American Water Company to Revise the Kentucky River
Authority Water Withdrawal Fee*
Case No. 2009-00124

Dear Mr. Derouen:

Submitted herewith for filing is the following document: Original and ten (10) copies of the Memorandum of the Kentucky Municipal Utility Association.

If you have questions, do not hesitate to contact this office.

Sincerely,



Jack B. Bates

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COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

SEP 30 2009

PUBLIC SERVICE
COMMISSION

In the Matter of:

TARIFF FILING OF KENTUCKY-AMERICAN)
WATER COMPANY TO REVISE THE) CASE NO. 2009-00124
KENTUCKY RIVER AUTHORITY)
WITHDRAWAL FEE)

MEMORANDUM OF THE KENTUCKY MUNICIPAL UTILITY ASSOCIATION

* * * * *

The Kentucky Municipal Utility Association (“KMUA”), by counsel, and pursuant to the orders of the Public Service Commission (“Commission”) entered August 18 and September 3, 2009, states for its memorandum as follows:

Introduction

KMUA appreciates the opportunity to assist the Commission in its deliberation on these issues. KMUA represents 43 utilities that provide the essential services of electric power, water, waste water, natural gas and telecommunications – including Internet access, cable television, telephone and other specialized services. Members are locally owned and operated and they are governed by city officials or independent utility boards. Members take pride in providing low-cost, efficient and reliable service to over a million citizens in cities throughout Kentucky. Member managers live and work in their communities, providing services and employment to the citizens of Kentucky.

KMUA members provide water service to customers in the Kentucky River Basin, and as a consequence must pay water use fees that are imposed by the Kentucky River Authority (“KRA”)¹. Commission action regarding the proposed tariff revision by Kentucky American

¹ The water use fees are set forth in both statutory law (KRS 151.723) and in Kentucky administrative regulations (420 KAR 1:040 and 1:050). Legal enforcement provisions are found in KRS 151.725 and 151.990.

Water Company (“KAWC”) and the company’s handling of water use fees² can have an impact on KMUA’s members.

KMUA maintains that the KRA fee should remain a separate line item on customers’ bills subject to periodic tariff changes coincident with the KRA fee adjustments.

BACKGROUND

On February 26, 2009, KAWC notified the Commission of a proposed tariff revision concerning the water use fee assessed by the KRA. The Commission’s August 18, 2009 order describes the regulatory history of the fees and how they have been treated by KAWC and the Commission. The order concludes by determining that the Commission’s ultimate findings in this case may have significant implications on the methods that other utilities use to recover KRA fees. Accordingly, the Commission found that all public and municipal water utilities under the Commission’s jurisdiction and that are assessed KRA fees should be given notice of this proceeding and an opportunity to intervene, and submit written memoranda on the KRA fee issue.

On August 31, 2009, KMUA filed its motion for full intervention. The Commission granted the motion in its order entered September 3, 2009.

Historically, the Commission has allowed utilities, through tariff provisions, to bill KRA fees as a separate line item. The line item represents a customer’s proportionate share of the fee.

ISSUES PRESENTED

As part of its inquiry into the reasonableness and lawfulness of KAWC’s proposed tariff revision, the Commission posed in its August 18 order three issues for parties to address:

- A. Should the fees that the KRA assesses for water withdrawals from the Kentucky River Basin be considered as a normal cost of providing water service and recovered through general rates only?

² KMUA acknowledges settled law that water use fees assessed by the KRA are not taxes, as held in the appellate case of *Kentucky River Authority v. City of Danville*, 932 S.W.2d 374 (Ky. App. 1996), cert. den. 520 U.S. 1186, 117 S.Ct. 1469 (1997).

- B. Why is it reasonable to consider the fees that the KRA assesses for water withdrawals from the Kentucky River Basin as an extraordinary expense that must be recovered through a separate line item on customer bills and with a methodology that ensures total recovery of such fees?
- C. Whether use of a methodology that considers the fees that the KRA assesses for water withdrawals from the Kentucky River Basin as an extraordinary expense recoverable through a separate line item on customer bills and that ensures total recovery of such fees impedes Kentucky-American and other water utilities from implementing practices to reduce the volume of unaccounted-for water.

KMUA'S RESPONSES

- A. THE WATER USE FEES ASSESSED AND COLLECTED BY THE KENTUCKY RIVER AUTHORITY SHOULD NOT BE CONSIDERED AS A NORMAL COST OF PROVIDING WATER SERVICE AND RECOVERED THROUGH GENERAL RATES ONLY.

The KRA water use fee should be treated as a separate tariff charge on customer bills rather than being recovered through general rates. A line item approach both streamlines the rate regulation process and advances the goals of transparency and financial accountability. A separate line item more clearly identifies the fee as non-operational and better informs customers and the public that a specified portion of the utility's billing goes to the KRA, whose mission is to protect the Kentucky River Basin through infrastructure improvements (e.g., locks and dams repair), watershed management, and other projects. See KRS 151.720.

- B. IT IS REASONABLE TO CONSIDER THE KRA WATER USE FEES AS AN EXTRAORDINARY EXPENSE RECOVERABLE THROUGH A SEPARATE LINE ITEM ON CUSTOMER BILLS AND A CORRESPONDING METHODOLOGY TO ENSURE TOTAL RECOVERY.

The extraordinary expense method is a reasonable method and the water use fees should be passed through to the customer directly for two reasons. First, the separate line item creates transparency in billing for the customer. This line item makes it clear that the fee is separate from the municipal utility's normal operations and informs the customer that a portion of his or her water bill goes directly to the KRA to support the KRA's infrastructure improvements and

projects. Second, if a municipal utility cannot implement the KRA fee coincident with the KRA fee changes, then it will have no way to recover cost increases until the next rate case approval. Such an approach would be unduly complex and expensive. For example, if the KRA fee cannot be altered as a tariff filing and collected as a separate line item, the utility is then forced to file a rate application for every KRA adjustment leading to increased regulatory costs that are passed on to its Commission-regulated customers. The entire cost of such filings is due solely to the regulation of the contracts with those customers. If the utility chooses not to pursue a filing and simply waits until its next rate case, then its unregulated customer class will essentially subsidize the regulated class for the period between rate cases. That subsidy is never recovered from the regulated class. The end result is a Commission-mandated subsidy of the regulated customer class. Finally, including the KRA fee in a utility's rate structure places the Commission in the position of evaluating the reasonableness of any proposed KRA fee.

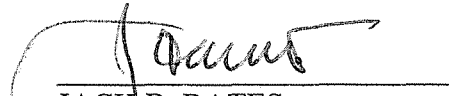
C. THE AFORE-MENTIONED RECOVERY METHOD SHOULD NOT IMPEDE KAWC AND OTHER WATER UTILITIES FROM IMPLEMENTING PRACTICES TO REDUCE THE VOLUME OF UNACCOUNTED-FOR WATER.

KMUA understands that KAWC is presently required to address lost water irrespective of the methodology that is chosen for recovery of KRA water use fees. The line-item approach should not interfere with a bona fide program of reducing unaccounted-for water. Additionally, KMUA also understands that KAWC is in the process of reporting to the Commission on the issue of lost water in another case.

CONCLUSION

The KRA water use fee should be treated as a separate tariff charge for customer bills. The extraordinary expense approach is a reasonable method of recovery of the fees and line item treatment should not interfere with a bona fide program for reduction of lost water.

Respectfully submitted,



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COUNSEL FOR KMUA

CERTIFICATE OF SERVICE


I hereby certify that on September 30, 2009, a true and accurate copy of the foregoing MEMORANDUM OF THE KENTUCKY MUNICIPAL UTILITY ASSOCIATION was served by United States mail, postage prepaid, to the following:

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