

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INVESTIGATION OF BOONE COUNTY WATER)	
DISTRICT'S DECISION TO CHANGE WATER)	
SUPPLIERS AND OF THE AMENDMENT OF WATER)	
SUPPLY AGREEMENTS BETWEEN NORTHERN)	CASE NO. 2000-206
KENTUCKY WATER SERVICE DISTRICT AND)	
BOONE COUNTY WATER DISTRICT AND THE CITY)	
OF FLORENCE, KENTUCKY)	

O R D E R

Boone County Water District ("Boone District") has submitted for Commission review and approval certain agreements that, when implemented, will result in the Cincinnati Water Works ("CWW") replacing Northern Kentucky Water District ("NKWD")¹ as exclusive water supplier to Boone District and the city of Florence, Kentucky ("Florence"). By this Order, we find reasonable, and approve the terms of, the agreement between Boone District, NKWD and Florence that modifies their present water supply agreements and provides for the termination of general service.

PROCEDURE

On March 13, 2000, Boone District submitted certain agreements for Commission review and approval. On May 1, 2000, the Commission, finding that an investigation should be initiated into those agreements and Boone District's decision to change water suppliers, established this proceeding. We further directed that Boone

¹ While this proceeding was pending, NKWD amended its name from Northern Kentucky Water Service District to Northern Kentucky Water District.

District, NKWD, and Florence be made parties to this proceeding. We subsequently permitted the Attorney General of the Commonwealth of Kentucky to intervene in this proceeding.

On August 9, 2000, the Commission held a public hearing in this matter. The following persons testified: Paul E. Kroger, former manager of Boone District; David E. Rager, Director of CWW; Michael A. Taylor, P.E.; Phil Trzop, manager of Boone District; Ronald G. Crume, chairman of Boone District's Board of Commissioners; Harold L. Hedges, general manager of the Florence Water and Sewer Commission; Ronald J. Barrow, acting manager of NKWD; Richard Harrison, P.E.; and Carlos Miller, P.E.

The parties in this matter submitted written briefs on September 9, 2000. This matter then stood submitted for decision.

BACKGROUND

NKWD is a water district that is organized pursuant to KRS Chapter 74. It owns and operates facilities used to distribute and furnish water to approximately 60,051 retail customers in Boone, Campbell, Kenton, and Pendleton counties, Kentucky.² It also provides wholesale water service to Boone District, Pendleton County Water District, and the cities of Florence, Bromley, Ludlow, Taylor Mill, and Walton. Approximately 25.8 percent of its total annual water sales are to Boone District and Florence.³

Boone District is a water district that is organized pursuant to KRS Chapter 74. It owns and operates facilities used to distribute water to approximately 13,506 customers

² Annual Report of Northern Kentucky Water Service District for the Year Ended December 31, 1999 at 29.

³ Id. at 32.

located in the unincorporated areas of Boone County, Kentucky.⁴ Boone District has no water treatment facilities, but purchases its entire water requirement from NKWD. In 1999, Boone District purchased approximately 1,729,258,900 gallons of water from NKWD.⁵ NKWD and Boone District executed their current water supply contract in 1990. This contract, which provides for NKWD to be Boone District's exclusive water supplier, remains in effect until December 2010.⁶

Florence is a city of the third class that owns and operates a water distribution system to serve its residents. In 1986 Florence and NKWD executed a water supply agreement that declared NKWD to be Florence's exclusive water supplier. This contract expires in 2006. In 1999 Florence purchased approximately 1,116,663,800 gallons of water from NKWD.⁷

In 1995, Kenton County Water District No. 1 ("Kenton District"), NKWD's predecessor,⁸ determined that it would lack sufficient capacity to meet its maximum day demands between the years 2000 and 2001. It began reviewing its options to meet its

⁴ Annual Report of Boone County Water District for the Year Ended December 31, 1999 at 29.

⁵ Id. at 32.

⁶ Transcript of Evidence ("T.E.") at 7-8.

⁷ Annual Report of Northern Kentucky Water Service District for the Year Ended December 31, 1999 at 32.

⁸ Kenton County Water District No. 1 entered the contracts with Boone District and Florence. On January 1, 1997, Kenton County Water District No. 1 merged with Campbell County Kentucky Water District to form NKWD.

contractual duties.⁹ Kenton District eventually determined that two options were feasible for resolving its capacity needs: the purchase of water from CWW or the construction of a 40-million-gallon-per-day (“MGD”) water treatment facility near Belleview, Kentucky.¹⁰

While Kenton District (subsequently NKWD) examined these options, CWW in July 1997 proposed to Boone District and Florence that it exclusively supply their combined water needs for a 35-year period.¹¹ It proposed to construct a 36-inch pipeline from its Robert Miller Treatment Plant, which is located on the northern bank of the Ohio River, under the Ohio River to a location in Boone County, Kentucky to connect to the water utilities’ distribution systems. This pipeline could initially provide 20 MGD and ultimately provide 30 MGD.¹² The initial rate at which water service would be provided was \$.95 per 100 cubic feet (“CCF”).

To address this issue on a regional basis, NKWD, Boone, Florence and CWW jointly commissioned a study to review the available options. This study, entitled the “Northern Kentucky Water Study,”¹³ reviewed two options: NKWD’s construction of a

⁹ T.E. at 8. A siting study, which Black and Veatch prepared for Kenton County Water District No. 1 in October 1995, noted that the water district “will be unable to meet demand conditions relatively soon, without water restrictions.” See Boone District’s Response to the Commission’s Order of May 1, 2000, Exhibit 6-D at II-3.

¹⁰ Boone District’s Response to the Commission’s Order of May 1, 2000, Item 6, Exh. 6B at 1.

¹¹ Boone District’s Response to the Commission’s Order of May 1, 2000, Item 1.

¹² Id.

¹³ See Boone District’s Response to the Commission’s Order of May 1, 2000, Exhibit 6B.

new water treatment facility and NKWD's purchase of water from CWW and subsequent resale to Boone District and Florence.

In November 1997, the study's authors issued their report in which they found that the cost for NKWD to construct a new water treatment facility would be approximately \$112 million (nearly \$200 million if financing costs were considered) and that the construction costs for CWW to supply Northern Kentucky were \$76 million (approximately \$120 million with financing costs). The study also considered a third alternative – CWW's direct sale of water to Boone District and Florence. This alternative resulted in construction costs of \$20 million and, if financing costs were included, total costs of \$30 million.¹⁴ The study assumed that these alternatives would be financed over a 35-year period.

Having considered these alternatives, the study's authors concluded:

When the cost of construction, financing, operations, and purchase of water costs were projected over a 35-year period, the purchase of water from Cincinnati was shown to save the Northern Kentucky Water District \$330 million over the study. A direct supply to Boone County and Florence was identified to cost considerably less to build and saved those utilities \$160 million over the 35-year period.¹⁵

After the issuance of the report, Boone District's Board of Commissioners chose to remain as a customer of NKWD and to extend its existing water supply contract with NKWD until 2035 to facilitate the construction of the proposed water treatment plant. Boone District's Commissioners found that, "although the purchase of water from CWW provided a savings, the amount of the savings was not sufficient to alter . . . [its] existing

¹⁴ Id., Executive Summary at 1.

¹⁵ Id.

relationship with [NKWD].”¹⁶ On April 21, 1998, they authorized negotiations with NKWD to extend its water supply contract.

While Boone District’s negotiations with NKWD were proceeding, CWW, on June 17, 1998, submitted a new proposal to Boone District and Florence for direct water service. It proposed to supply water to Boone District and Florence at a rate of \$.79 per CCF for 30 years.¹⁷ It further proposed to discount the existing rate by 25 percent beginning in the twenty-sixth year of the contract. In subsequent negotiations, CWW revised its proposal to provide for a contract period of 25 years, an initial rate of \$.79 per CCF, and an 18 percent discount in the contract rate beginning in the twenty-first year of the contract.

For Boone District’s commissioners, CWW’s proposed rate represented “significant savings to Boone [District]’s and Florence’s customers in comparison to . . . projections of the overall cost of the construction of a new water treatment facility by” NKWD.¹⁸ On July 27, 1998, after considering the proposal, Boone District’s commissioners voted to negotiate with CWW for a new water supply and enter

¹⁶ Prefiled Testimony of Paul E. Kroger at 7. See also Boone District’s Response to the Commission’s Order of May 1, 2000, Item 5 at 5 (“It appeared that Cincinnati’s proposal would save Boone \$6 to \$8 million over the life of the agreement. However Boone did not consider these savings to be sufficiently significant to merit changing its supplier from NKWSD to Cincinnati, and Boone was prepared to select NKWSD’s proposal.”)

¹⁷ Boone District’s Response to the Commission’s Order of May 1, 2000, Item 1, Exhibit 1b.

¹⁸ Prefiled Testimony of Paul E. Kroger at 7.

negotiations with NKWD to terminate the existing water supply agreement. Florence reached a similar decision.¹⁹

On March 2, 1999, Boone District, Florence, and the Boone-Florence Water Commission (“Water Commission”)²⁰ executed an agreement with CWW for a new water supply (“Water Supply Agreement”). This agreement provides that CWW will be the exclusive water supplier to the Water Commission, Boone District, and Florence for a period of 25 years.²¹ It requires CWW initially to provide a maximum of 20 MGD to the Water Commission and eventually to provide a maximum of 30 MGD. It further requires CWW to construct at its own expense the capital improvements, estimated to cost \$24,988,000, necessary to transport this water to a delivery point in Boone County,

¹⁹ On January 14, 1999, Cincinnati Water Works amended its proposal to \$.82 per CCF to reflect increased costs of chlorination. See Florence’s Response to the Commission’s Order of May 1, 2000, Item 2d.

²⁰ KRS 74.430 authorizes cities and water districts to acquire and jointly operate sources of supply of water. KRS 74.440 authorizes a county judge executive, upon the proposal of a city and water district for the acquisition and joint operation of a source of supply of water, to create a water commission for that purpose. On October 5, 1998, Boone District’s Board of Commissioners adopted a resolution proposing the creation of a joint water commission to operate sources of water supply jointly with Florence. See Boone District’s Response to the Commission’s Order of May 1, 2000, Item 14a. On October 13, 1998, Florence enacted an ordinance in which it made a similar proposal. See Florence’s Response to the Commission’s Order of May 1, 2000, Item 12. On November 24, 1998, Boone County Judge/Executive Larry S. Burcham issued an executive order creating the Boone-Florence Water Commission. See Boone District’s Response to the Commission’s Order of May 1, 2000, Item 14b.

²¹ The Water Supply Agreement is effective for 29 years from the date of execution. It contemplates that during the first 48 months of the agreement, the parties will be constructing the facilities necessary for the delivery and receipt of water service. Water service is not contemplated to commence until the fifth year of the Water Supply Agreement. See, e.g., Water Supply Agreement §§ 3A and 7.

Kentucky to the Water Commission. The Water Supply Agreement expressly provides that CWW will not furnish retail service in Kentucky.²²

The Water Supply Agreement establishes the initial rate for wholesale service to the Water Commission at \$0.82 per CCF or 89 percent of the current rate paid by Cincinnati residential customers whose monthly usage exceeds 60,000 cubic feet.²³ This ratio is to remain in effect throughout most of the contract period. For example, if CWW raises its current rates, the new rate assessed to the Water Commission will be 89 percent of the new rate to Cincinnati residential customers. After the twentieth year of the contract, the rate in effect will be reduced by 18 percent.²⁴

The Water Supply Agreement further requires Boone District, Florence and the Water Commission to construct approximately \$23,632,000 in new facilities. These facilities include: approximately 27 miles of water main ranging in size from 16 inches to 48 inches, a two-million-gallon elevated water storage tank, a one-million-gallon ground storage reservoir (expandable to two million gallons) and a re-pumping facility.²⁵ The total cost of these facilities, when the legal, administrative, engineering, and land acquisition costs and contingencies are included, is estimated at \$31.9 million.²⁶

²² Id. at § 1.

²³ Water Supply Agreement § 7.

²⁴ Id.

²⁵ Prefiled Testimony of Michael A. Taylor at 4-5.

²⁶ Water Supply Agreement § 4B; Boone District's Response to the Commission's Order of May 1, 2000, Item 19.

Boone District and the Water Commission subsequently executed an Agreement to define the terms under which the Water Commission would provide wholesale water service (“Wholesale Service Agreement”). This Agreement provides that, inter alia, the Water Commission would be Boone District’s exclusive water supplier for a period of 25 years.²⁷ The Agreement would commence upon CWW providing water service to the Water Commission, and the Water Commission would design, construct, own, maintain and operate all the capital improvements required by the Water Supply Agreement.²⁸ Boone District and the Water Commission further agreed that the rate for wholesale service will be sufficient to recover the principal and interest on any revenue bonds that the Water Commission issues, to pay the cost of operating and maintaining the Water Commission’s facilities, and to provide adequate fund renewals, replacements and reserves.²⁹ Florence executed a similar agreement with the Water Commission.

While negotiating the Water Supply Agreement with CWW, Boone District and Florence also negotiated with NKWD to terminate their existing water supply agreements. After lengthy negotiations, these parties executed, on February 29, 2000, an agreement to amend their existing water supply agreement and to provide for its early termination (“Termination Agreement”). They agreed, inter alia, that:

- Boone District’s and Florence’s existing agreements with NKWD are effectively terminated on January 1, 2004.
- NKWD is relieved of its obligation to supply Boone District’s and Florence’s total water requirements. In lieu of this obligation, NKWD

²⁷ Wholesale Service Agreement ¶ 2 and ¶ 3.

²⁸ Id. at ¶ 5.

²⁹ Id. at ¶ 10.

must supply Boone District a maximum of 5.95 MGD and Florence a maximum of 4.05 MGD.

- Boone District and Florence will make lump sum payments of \$2,725,077 and \$764,923, respectively, to NKWD.
- Boone District will pay \$1,303 to NKWD for each day prior to January 1, 2004 in which its existing agreement is terminated.
- Florence will pay \$968 to NKWD for each day prior to January 1, 2004 in which its existing agreement is terminated.
- Florence and Boone will disconnect their water systems from NKWD and bear the cost of such disconnection.

On March 9, 2000, Boone District submitted the Water Supply Agreement, Wholesale Supply Agreement, and the Termination Agreement to the Commission for our approval or, in the alternative, for an Order declaring that Commission approval of the agreements is not required. On May 1, 2000, the Commission initiated this proceeding to investigate the reasonableness of the Termination Agreement and Boone District's decision to change water suppliers. A hearing in this matter was held on August 8, 2000.

DISCUSSION

Water Supply Agreement and Wholesale Supply Agreement

While Boone District has presented the Water Supply Agreement and Wholesale Supply Agreement to the Commission for review, the scope of our review of these agreements is very limited. We have previously held that the selection of a water supplier is a matter of management discretion. See City of Newport, Kentucky v. Campbell County Kentucky Water District, Case No. 89-014 (Ky.PSC Jan. 31, 1990) at 19-20. Our approval of Boone District's and Florence's entry into the Water Supply

Agreement or Boone District's entry into the Wholesale Service Agreement, therefore, is not necessary.³⁰

As to the rate and service provisions of the Wholesale Supply Agreement, they are expressly exempted from Commission Regulation. KRS 74.510 states:

Since the activities of a [joint water source] commission created pursuant to KRS 74.420 to 74.520 are limited to the supply of water under contract to cities or to water distribution systems which are regulated by the Public Service Commission, including water districts and water associations, as provided in KRS 74.420 to 74.520, and such a commission has no authority to supply water to individual private consumers, **such a commission shall not be deemed to constitute a "utility" or "person" within the meaning and application of KRS Chapter 278 and a commission shall not be subject to the jurisdiction of the Public Service Commission.**

(Emphasis added). Commission approval of the terms of the Wholesale Supply Agreement is, therefore, also unnecessary.

We next consider the rate and service provisions of the Water Supply Agreement. The Commission's jurisdiction extends "to all utilities in this state."

KRS 278.040(2). A utility is

any person except a city, who owns, controls, or operates or manages any facility used or to be used in connection with . . . [t]he diverting, developing, pumping, impounding, distributing, or furnishing of water **to or for the public**, for compensation.

KRS 278.010(3)(d) (emphasis added). Where a person provides wholesale water service to one person or entity, does not sell to a jurisdictional utility, and has no

³⁰ As Florence is a municipal utility and therefore exempted from Commission regulation, its decision to enter the Water Supply Agreement and the ramifications of that decision are not within the Commission's purview. See KRS 278.010(3); McClellan v. Louisville Water Co., Ky., 351 S.W.2d 197 (1961).

expectation of making any retail sale to Kentucky customers, it does not provide service to the public. See, e.g., Kentucky Pioneer Energy, LLC, Case No. 2000-075 (Ky.P.S.C. July 13, 2000); Calvert City Power I, L.L.C., Case No. 99-058 (Ky. P.S.C. July 6, 1999). Under the terms of the Water Supply Agreement, CWW will provide wholesale water service to the Water Commission only. It will not provide any retail service. The Water Commission is not a public utility subject to Commission jurisdiction. See KRS 74.510. As CWW is not providing service to the “public” in this state, it is not a utility and its rates and service are therefore outside our jurisdiction. The Commission therefore finds that the Water Service Agreement’s provisions regarding rates and service do not require our approval.

Pursuant to KRS 278.200³¹ and the holding of Simpson County Water District v. City of Franklin, Ky., 872 S.W.2d 460 (1994), the Commission has the authority to review the rates for utility service assessed by a city to a utility. Since the Water Commission is not a utility, see KRS 74.510, however, neither this statute nor the Court’s holding in Simpson County confers upon us the authority to regulate CWW’s wholesale rates.

³¹

The commission may, under the provisions of this chapter, originate, establish, change, promulgate and enforce any rate or service standard of any utility that has been or may be fixed by any contract, franchise or agreement between the utility and any city, and all rights, privileges and obligations arising out of any such contract, franchise or agreement, regulating any such rate or service standard, shall be subject to the jurisdiction and supervision of the commission, but no such rate or service standard shall be changed, nor any contract, franchise or agreement affecting it abrogated or changed, until a hearing has been had before the commission in the manner prescribed in this chapter.

While neither Agreement requires Commission approval, the effect of these Agreements upon Boone District's rates and quality of service provisions is a matter within the Commission's jurisdiction. To the extent that the Agreements would adversely affect Boone District's rates or quality of service and that Boone District's entry into the Agreements can be considered unreasonable or imprudent, the Commission has the authority to adjust Boone District's rates to protect its ratepayers from any unreasonable costs resulting from an unreasonable or imprudent decision or to direct any necessary actions to protect against the degradation of service quality.³² The Commission's inquiry with regard to the Agreements, therefore, is whether they were reasonably entered into and whether they will lead to unreasonable rates or a degradation of service quality.

The record clearly indicates that an additional source of supply is necessary. NKWD, the area's sole water supplier, currently lacks capacity to meet the projected maximum daily demands of retail and wholesale customers. Boone District argues that only two alternatives for resolving this capacity deficit exist. NKWD must either expand its water treatment capacity by constructing a new water treatment plant or Boone District must obtain its water supply from CWW. Boone District argues that acquiring its source of supply from CWW is the least costly method and will result in cost savings of

³² See, e.g., City of Newport, Kentucky v. Campbell County Kentucky Water District, Case No. 89-014 (Ky.PSC Jan. 31, 1990) at 20.

approximately \$41,553,683 over the life of the Water Supply Agreement when compared to the cost of continuing to purchase water from NKWD.³³

To obtain its projected cost savings, Boone District compares the projected cost of purchasing water from NKWD and from CWW. It determined the cost of purchasing water from NKWD by applying the water rates NKWD would charge if a new treatment plant were constructed to its expected annual demand.³⁴ It further added to this amount the annual debt service costs of capital improvements that would be necessary to enable Boone District to take water from the new water treatment plant.³⁵ It concluded that the cost of purchasing water from NKWD for a 25-year period would be \$168,840,794.³⁶

Boone District calculated the cost of obtaining water from CWW by applying the Water Supply Agreement's wholesale rate to its expected annual demand over the same 25-year period. Its projection assumed an annual average increase in the

³³ See Prefiled Testimony of Paul E. Kroger, Exhibit 3 (Revised). In this Exhibit, Mr. Kroger revised his calculations to reflect the cost of termination agreement and reductions in Cincinnati Water Works' rates that are required to occur in the twenty-first year of the Water Supply Agreement.

³⁴ Boone District used rate projections that NKWD had prepared for the "Northern Kentucky Water Study." Prefiled Testimony of Paul E. Kroger at 9. See also NKWD's Response to the Commission's Order of May 1, 2000, Item 1, Exhibit 1A.

³⁵ The authors of the Northern Kentucky Study found that the construction of approximately \$8,478,000 in distribution main improvements were necessary for Boone District to take service from NKWD's proposed 20 MGD water treatment plant. An additional \$2,150,000 of distribution main improvements would be necessary when that plant's capacity was expanded to 40 MGD. Boone District's calculation of debt service cost assumed the issuance of \$8 million in revenue bonds payable over 25 years and having an interest rate of 5.5 percent. See Boone District's Supplemental Response to the Commission's Order of May 1, 2000, Exhibit 6G.

³⁶ Prefiled Testimony of Paul E. Kroger, Exhibit 3 (Revised), Column F, Line 40.

wholesale rate of 2 percent and an 18 percent decrease in the rate in the twenty-first year of the Water Supply Agreement. Boone District then added the cost of servicing \$15 million in construction improvements necessary to transmit water from the CWW's point of delivery to Boone District and Florence.³⁷ Based upon these projections, the cost of taking water from CWW was projected to be \$127,287,111,³⁸ or \$41,553,683 less than the NKWD option.

The Commission finds several flaws in Boone District's analysis. First, a mathematical error occurred in Boone District's calculation of the total water cost under the NKWD option. Using all of Boone District's assumptions, its total cost of purchasing water from NKWD over the 25-year period is only \$165,824,446.

Second, we question Boone District's method for calculating the cost of water under the CWW option. Boone District assumes a direct purchase from CWW rather than a purchase through the Water Commission. Instead of CWW's rate, Boone District should have used the Water Commission's projected rate. This rate, while based upon the same assumptions regarding increases in CWW's wholesale rate and Boone District's and Florence's projected water demand, considers debt service on a projected bond issuance of \$38 million to cover the cost of all system improvements and the

³⁷ Prefiled Testimony of Paul E. Kroger at 10. Boone District's calculation of debt service cost assumed the issuance of \$15 million in revenue bonds payable over 25 years and having an interest rate of 5.5 percent. See Boone District's Supplemental Response to the Commission's Order of May 1, 2000, Exhibit 6G.

³⁸ Prefiled Testimony of Paul E. Kroger, Exhibit 3 (Revised), Column G, Line 40.

parties' cost of terminating their existing contracts.³⁹ It is, therefore, a more realistic projection.⁴⁰ Using the projected Water Commission rate and adjusting that rate for the rate reduction which will occur in the twenty-first year of the Water Supply Agreement,⁴¹ we find that Boone District's cost for water under the CWW option is \$140,802,988, or a savings of \$25,021,458. Our calculations are set forth in Appendix A to this Order.

Despite these cost savings, the Commission is unable to conclude that Boone District's decision to switch water suppliers will result in reasonable water costs over the life of the Water Supply Agreement. These cost calculations fail to consider the cost of any new pipeline that may be required in the later years of the Water Supply Agreement.

According to Boone District and Florence's projections, the two water distribution systems' maximum daily demand for water will exceed CWW's contractual commitment

³⁹ While Boone District assumed \$23 million in total capital improvements, it had previously agreed that the expected cost of these improvements, when engineering, legal, and other costs were considered, was \$31,943,301. See Water Supply Agreement § 4B; Boone District's Response to the Commission's Order of May 1, 2000, Item 19. The Water Commission will also assume Boone District and Florence's payments to NKWD to terminate their existing water supply contracts, which totaled \$3.49 million, and intended to include the cost of those payments in its revenue bond issuances. T.E. at 20-23.

⁴⁰ For the projection of the Water Commission's rate, see Boone District's Response to the Commission's Order of May 1, 2000, Item 34; Florence's Response to the Commission's Order of May 1, 2000, Item 27.

⁴¹ The projected Water Commission rate changes that reflect the 18 percent reduction in Cincinnati Water Works' wholesale rate are shown in Appendix B to this Order.

of 30 MGD in 2018.⁴² By 2025 Boone and Florence will have a combined maximum daily demand of 38.8 MGD. Their combined maximum daily demand in 2029 is projected to be 44.37 MGD. While CWW's plans to rely upon existing storage,⁴³ the variability of demand by different types of consumers, and emergency connections to NKWD may provide some relief, additional sources of water will be required before the end of the Water Supply Agreement.⁴⁴ CWW in fact has suggested that, upon agreement of the parties, an additional pipeline may be constructed to meet Boone District and Florence's demands in excess of 30 MGD.⁴⁵ The cost of that additional pipeline reduces the expected cost savings resulting from the selection of the CWW option. The record, however, contains no evidence to quantify such costs.

We also note that projections regarding CWW's rate are merely projections. As CWW is not subject to Commission jurisdiction, Boone District and its ratepayers will lack some of the protections against excessive and unreasonable rates that they currently possess with NKWD as their water supplier. Boone District argues that the

⁴² Id. at 60-61. Under the terms of the water supply agreement, CWW must supply a maximum of 30 MGD. Boone District and Florence's expected maximum daily demand in 2018 is 30.58 MGD and will increase steadily thereafter.

⁴³ Under the terms of the Water Supply Agreement, Boone District, Florence and Water Commission must maintain on their combined distribution and transmission system water storage facilities capable of storing 80 percent of their combined average-day demand. See Water Supply Agreement § 7. Therefore, these entities must have at least 12.16 million gallons of storage in existence.

⁴⁴ T.E. at 61-63. See also Boone District's Response to the Commission's Order of May 1, 2000, Item 23.

⁴⁵ T.E. at 71. In contrast, NKWD's proposed 40 MGD water treatment facility would meet NKWD's projected maximum daily demands (including Boone District and Florence) until at least 2035.

Water Supply Agreement contains adequate protections. It notes that the Water Supply Agreement requires the creation of an advisory committee,⁴⁶ which will meet at least annually, and states that Boone District may voice its comments regarding any proposed rate adjustment through that committee. The Water Supply Agreement also requires the formation of a Conflict Resolution Committee to resolve any matter of mutual concern or conflict.⁴⁷ Furthermore, Boone District and the Water Commission may appear before the Cincinnati City Council and argue its position to that body. Finally, they may seek judicial review of any action of the Cincinnati City Council to adjust rates.

Boone District places great emphasis on the Water Supply Agreement's provision that restricts any increase in CWW's wholesale rate to 89 percent of the increase in CWW's rate to residential customers in the monthly consumption bracket for usage in excess of 60,000 cubic feet. This provision, Boone District argues, limits the size of any rate adjustment since the members of the Cincinnati City Council must explain such adjustments when they stand for re-election.⁴⁸

We have previously noted that the absence of Commission jurisdiction over the supplier is not the controlling factor in determining whether that supplier can reasonably be selected.⁴⁹ The provisions of a water supply agreement may provide adequate

⁴⁶ Water Supply Agreement § 8.

⁴⁷ Id. at § 9.

⁴⁸ T.E. at 106.

⁴⁹ Case No. 89-014, City of Newport, Kentucky v. Campbell County Kentucky Water District (Jan. 31, 1990).

safeguards against excessive or unreasonable rates through the use of a reasonable cost allocation formula.

Boone District's Water Supply Agreement with CWW and the statutory procedures for rate adjustment that CWW must follow will provide some protection against excessive rates. Moreover, Boone District retains the right to resort to the federal courts in the event of an arbitrary or unreasonable action by its supplier. The Commission, however, does not share Boone District's opinion that the Cincinnati electorate will serve as an adequate shield. Only 412 customers of CWW are residential customers whose monthly consumption exceeds 60,000 cubic feet.⁵⁰ Virtually all of these customers are commercial or industrial customers and are ineligible to participate in any election. As a collective group, they have significantly less electoral power to prevent costs from being unreasonably shifted to their customer usage classification from those that include CWW's other 226,000 customers.

Notwithstanding these concerns, we find that evidence of record demonstrates that Boone District's selection of the CWW option will not result in unreasonable water purchase costs during the initial years of the Water Supply Agreement. Based upon the record, however, we are unable to conclude that unreasonable water costs will not be incurred over the entire life of the Water Supply Agreement. Such assessment depends upon several factors, such as CWW's rate adjustments and the realization of projected water demands. We will, therefore, continue to monitor Boone District's purchased water costs and its relationship with the Water Commission and CWW and take appropriate actions when required.

⁵⁰ Supplement to the Testimony of Boone County Water District, Exhibit D.

Termination Agreement

The Termination Agreement between NKWD, Florence, and Boone District presents three areas that require Commission inquiry. First, the Commission must determine whether Boone District's and Florence's required payments are reasonable. Second, the Commission must examine the reasonableness of the new water quantity provisions and the elimination of NKWD's obligation to meet Boone District's and Florence's total water requirements. Third, the Commission must review the proposed transfer of customers among the three entities.

The Termination Agreement provides that Boone District and Florence pay to NKWD \$2,725,077 and \$764,923, respectively. These payments are based on the premise that NKWD constructed certain system improvements to meet its obligation to provide water service to Boone District and Florence throughout the term of their current water supply contracts. While Boone District and Florence remain NKWD customers, they pay through their water rates a portion of the debt service on these improvements. Because they are departing NKWD's system before the completion of their contract terms and will no longer be purchasing water from NKWD, these debt service payments will be lost. The termination payments are intended to compensate NKWD for these lost payments.⁵¹

The parties calculated the payment amount by first determining NKWD's annual water treatment plant debt service. A water production allocation factor was then developed for Boone District and Florence based upon each entity's actual purchases and allocated share of line loss and plant use. This factor was then applied to NKWD's

⁵¹ Prefiled Testimony of Ronald J. Barrow at 3.

annual water treatment plant debt service to determine each entity's annual share of NKWD's debt service. The total amount of lost debt service was then determined by multiplying this amount by the number of remaining years on each existing contract as of January 1, 2004.⁵² (The parties assumed that Boone District and Florence would cease taking water from NKWD on January 1, 2004.) The total lost debt service payment was then discounted using an interest rate of 5.91 percent to reflect its present value as of September 29, 2000.⁵³

The parties further recognized that, should Boone District or Florence cease taking water from NKWD before January 1, 2004, NKWD would lose additional debt service payments. Using the same methodology as that used to calculate the initial termination payments, the parties determined that Boone District and Florence would pay an additional \$1,303 and \$968, respectively, for each day they cease taking water service before January 1, 2004.⁵⁴

Having reviewed the record, the Commission finds that the Termination Agreement's provisions related to Boone District's and Florence's payments are reasonable and should be approved. The premise behind the payments and the methodology used to calculate the payments are reasonable and are fully supported by the record. We further find that, in light of Boone District's and Florence's decision to

⁵² NKWD's Response to the Commission's Order of May 1, 2000, Item 18b. The total amount of lost debt service related to Boone District was \$3,309,104. It was \$928,858

⁵³ Boone District's Response to the Commission's Order of May 1, 2000, Item 30, Exhibit 30D.

⁵⁴ Id.

depart NKWD's system, the Termination Agreement's allocation of all costs of system separation to Boone District and Florence is reasonable.⁵⁵

The next area of inquiry is NKWD's obligation to serve Boone District and Florence. Currently NKWD must supply Boone District's and Florence's total water requirements. The Termination Agreement relieves NKWD of this obligation and commits NKWD to providing Boone District and Florence to no more than 5.95 MGD and 4.05 MGD respectively. These amounts are significantly less than those utilities' projected maximum daily demands.⁵⁶

NKWD argues that the reduction in its service obligation is reasonable under the circumstances. It contends that it cannot meet its total system requirements without the changes unless new facilities are constructed. Given Boone District's and Florence's imminent departure, the construction of such facilities is wasteful. In lieu of such construction, Boone District and Florence have agreed to the imposition of water conservation measures to reduce their peak demands. NKWD has also agreed to implement such measures when necessary, but only after Boone District and Florence have implemented such measures and have gone to a higher level of conservation. In addition to conservation measures, Boone District states that CWW may be able to

⁵⁵ Florence estimates its share of these costs to be approximately \$12,100. Supplement to Direct Testimony of Harold Hedges ¶ 3. Boone District estimates its share of these costs at approximately \$50,000. T.E. at 88.

⁵⁶ Boone District and Florence's projected maximum daily demands (in MGD) are set forth below:

Utility	2001	2002	2003
Boone District	9.7	10.3	10.9
Florence	5.85	5.96	6.08

supply water earlier than January 1, 2004 to avert any problems that may occur during the summer of 2003.

We find the proposed reduction in the amount of water that NKWD must supply to Boone District and Florence is reasonable. The parties have agreed to conservation measures in the event that peak demands are experienced. Moreover, they have appropriately and reasonably allocated the burden of conservation among themselves. Insofar as Boone District and Florence have announced their intention to depart NKWD's system, additional investment on NKWD's part to meet their requirements would not be cost-effective or prudent. Our review of the proposed conservation plans, furthermore, indicates that they are likely to reduce consumption sufficiently to alleviate any major problems. We note, however, that customers of Boone District and Florence are likely to experience some inconveniences if extended hot, dry weather occurs at any time before January 1, 2004.

Finally, the Termination Agreement provides for the transfer of several customers between NKWD and Boone District and NKWD and Florence to facilitate the separation of their respective water distribution system. We agree that such transfer is necessary to achieve the separation. We find that these persons should be individually notified by mail of the pending transfer and direct Boone District and NKWD to notify their affected customers.

Other Issues

The Commission commends the parties for their efforts to obtain a regional solution to their supply needs and encourages the parties to continue their efforts toward this endeavor. Clearly one goal toward which all the parties should strive is the

development of emergency source of supply agreements that would permit greater flexibility in dealing with water emergencies. We also encourage Boone District, Florence, and NKWD to explore the feasibility of merging their respective systems to produce a stronger and more vibrant regional system that can more efficiently and more effectively serve the residents of Northern Kentucky. The Commission takes comfort in the statements of NKWD and Boone District officials that regional cooperation remains a key goal and that merger discussions will not be affected by the proposed change of supplier.

SUMMARY

Having considered the evidence and record and being otherwise sufficiently advised, the Commission HEREBY ORDERS that:

1. The Termination Agreement between NKWD, Boone District, and Florence is approved.
2. Within 30 days of the date of Order, NKWD and Boone District shall, if they have not already done so, notify by mail each of their customers who will be transferred to another water distribution utility as a result of the Termination Agreement.

Done at Frankfort, Kentucky, this 9th day of November, 2000.

By the Commission

ATTEST:


Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2000-206 DATED NOVEMBER 9, 2000

Contract Year	Year	Average Annual Water Bought	Cost of Water NKWD	BFWC Rate	Cost of Water BFWC	Savings with BFWC
1	2000	1601.2	\$3,814,892	2.13	\$3,410,556	\$404,336
2	2001	1665.3	\$3,943,632	2.12	\$3,530,436	\$413,196
3	2002	1731.9	\$4,077,522	2.09	\$3,619,671	\$457,851
4	2003	1801.2	\$4,342,850	2.07	\$3,728,484	\$614,366
5	2004	1873.2	\$4,511,440	2.06	\$3,858,792	\$652,648
6	2005	1948.2	\$4,668,042	2.05	\$3,993,810	\$674,232
7	2006	2026.1	\$4,830,908	2.03	\$4,112,983	\$717,925
8	2007	2107.1	\$5,042,432	2.02	\$4,256,342	\$786,090
9	2008	2191.4	\$5,220,273	2.02	\$4,426,628	\$793,645
10	2009	2279.1	\$5,428,019	2.01	\$4,580,991	\$847,028
11	2010	2370.2	\$6,166,438	2.00	\$4,740,400	\$1,426,038
12	2011	2465.0	\$6,389,239	2.01	\$4,954,650	\$1,434,589
13	2012	2563.6	\$6,595,317	2.02	\$5,178,472	\$1,416,845
14	2013	2666.2	\$6,861,936	2.02	\$5,385,724	\$1,476,212
15	2014	2772.8	\$7,140,286	2.03	\$5,628,784	\$1,511,502
16	2015	2883.7	\$7,344,367	2.04	\$5,882,748	\$1,461,619
17	2016	2999.1	\$7,584,295	2.06	\$6,178,146	\$1,406,149
18	2017	3119.1	\$7,895,001	2.07	\$6,456,537	\$1,438,464
19	2018	3243.8	\$7,440,866	2.08	\$6,747,104	\$693,762
20	2019	3373.6	\$7,680,909	2.10	\$7,084,560	\$596,349
21	2020	3508.5	\$7,823,949	1.82	\$6,385,470	\$1,438,479
22	2021	3648.9	\$8,113,051	1.83	\$6,677,487	\$1,435,564
23	2022	3794.8	\$8,489,613	1.84	\$6,982,432	\$1,507,181
24	2023	3946.6	\$8,529,080	1.85	\$7,301,210	\$1,227,870
25	2024	4104.5	\$7,738,179	1.87	\$7,675,415	\$62,764
26	2025	4268.7	\$8,151,910	1.88	\$8,025,156	\$126,754
Totals			\$165,824,446		\$140,802,988	\$25,021,458

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2000-206 DATED NOVEMBER 9, 2000

Year	Average Annual Water Bought	CWW Rate	Water Cost from CWW	Annual Bond SVC Requirement \$38,000,000	Total Requirement less Admin Cost	Rate to BCWD- FWSC (\$/1,000 gals)
2020	5913.0	1.34	\$7,923,420	\$2,832,900	\$10,756,320	1.82
2021	6132.0	1.37	\$8,400,840	\$2,832,900	\$11,233,740	1.83
2022	6351.0	1.39	\$8,827,890	\$2,832,900	\$11,660,790	1.84
2023	6570.0	1.42	\$9,329,400	\$2,832,900	\$12,162,300	1.85
2024	6789.0	1.45	\$9,844,050	\$2,832,900	\$12,676,950	1.87
2025	7008.0	1.48	\$10,371,840	\$2,832,900	\$13,204,740	1.88