

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

O R D E R

On February 26, 2009, Kentucky-American Water Company (“Kentucky-American”) notified the Commission of a proposed revision to its tariff related to the Kentucky River Authority (“KRA”) withdrawal fee. On March 30, 2009, the Commission suspended the revised rate for one day and allowed it to become effective on April 1, 2009, subject to further change as may be ordered by the Commission. The Commission stated that it would investigate the reasonableness and lawfulness of Kentucky-American’s proposed tariff revision.

The history of the KRA dates back more than 20 years. Recognizing that the locks and dams on the Kentucky River were critical to providing a source of clean water for several hundred thousand persons in central Kentucky, the Kentucky General Assembly in 1986 authorized the KRA to assume responsibility from the U.S. Army Corps of Engineers for these locks and dams.¹ Subsequently, it authorized the KRA to “collect water use fees from all facilities using water from the Kentucky River basin.”²

¹ KRS 151.700.

² KRS 151.720.

On December 17, 1993, the KRA promulgated administrative regulations that established fees for the withdrawal of surface water and groundwater from the Kentucky River basin.³

In anticipation of the KRA's assessment of water use fees, Kentucky-American, in Case No. 1992-00452, proposed revisions to its tariff to permit the billing, as a separate item, of an amount equal to the proportionate part of any KRA fees or charges.⁴ Prior to the proposed revision, Kentucky-American's tariff provided for a separate line item on customer bills to show an amount equal to the proportionate share of any license, franchise, or similar fee or tax imposed on Kentucky-American by local taxing authorities. By approving the grouping of the KRA fee with this broader group, the Commission implied that the KRA fee should be treated in the same fashion as a license, franchise, or similar fee or tax.

In Case No. 1994-00194,⁵ the Commission approved a methodology based upon estimated water withdrawals from the Kentucky River and estimated water sales. Under this methodology, Kentucky-American estimates its total payment of KRA user fees

³ See 420 KAR 1:040 (establishing Tier I fee); 420 KAR 1:050 (establishing Tier II fee). KRA assesses two user fees. Tier I fees are assessed on all persons who use the surface water or groundwater of the Kentucky River basin and are intended to fund watershed management projects that benefit the entire Kentucky River basin watershed and the KRA's general expenses. Tier II fees are intended to fund only projects that benefit a certain part of the Kentucky River basin and are assessed only to those persons who use the surface water or groundwater of the Kentucky River basin and derive a benefit from those projects.

⁴ Case No. 1992-00452, Notice of Adjustment of the Rates of Kentucky-American Water Company, at 49 (Ky. PSC Nov. 19, 1993).

⁵ Case No. 1994-00194, The Proposed Tariff of Kentucky-American Water Company (Ky. PSC June 9, 1994).

using projected water withdrawals for the upcoming calendar year. It then divides this total by its projected net water sales for the current calendar year to produce a KRA withdrawal fee rate for the current calendar year. If the KRA withdrawal rate were to produce total revenues that were insufficient or in excess of the amount of Kentucky-American's payment to KRA, then this over- or under-recovery of revenues was to be addressed in Kentucky-American's next general rate proceeding.

In Case No. 2000-00120,⁶ the Commission, at Kentucky-American's request, made further modifications to the KRA withdrawal fee. We modified the methodology to calculate the rate to provide for the under- or over-recovery of revenues.⁷ We further dispensed with customer notice of the proposed revisions to the fee, but directed Kentucky-American to publish the proposed fee revisions and the manner in which they were collected on its web site. We also directed Kentucky-American to include with any tariff revision filing a statement showing how the revised fee was calculated.

Despite significant over-recoveries during the four-year period of 2002-2005, Kentucky-American did not recalculate its KRA fee during that period. As a result, the Commission, in Case No. 2006-00154, determined that there was a "need for greater supervision of its [Kentucky-American's] assessment and collection of the KRA

⁶ Case No. 2000-00120, Application of Kentucky-American Water Company to Increase Its Rates, at 36-37 (Ky. PSC Nov. 27, 2000).

⁷ Under this revision, Kentucky-American would deduct any over-recovery or add any under-recovery to its estimate of KRA user fees for the current calendar year. It then would divide this amount by its projected net water sales for the current calendar year to produce a KRA withdrawal fee rate for the current calendar year. For an illustration of this methodology, see Kentucky-American's Response to the Commission's Order of May 1, 2006, Case No. 2006-00154, at Item 1 (filed May 16, 2006).

Withdrawal Fee.”⁸ The Commission required Kentucky-American to make annual adjustments and detailed filings, regardless of the amount of over- or under-recovery, and it mandated that the utility notify the public of its proposed adjustments pursuant to 807 KAR 5:011, Section 8. In addition, the Commission stated that “we seriously question the need for a separate line item to recover KRA water user fees and why recovery of such fees cannot be recovered through general rates. We place Kentucky-American on notice that this issue will be considered in Kentucky-American’s next general rate adjustment case.”⁹

Since that Order was issued in February 2007, Kentucky-American has filed two general rate adjustment cases.¹⁰ In both those rate cases, Kentucky-American settled on a rate with the Intervenors of the cases and the Commission approved the rates agreed to by the parties. Neither settlement agreement discussed the KRA withdrawal fee, and the Commission did not resolve the issue in its final Orders. In the more recent case, the Commission did, however, state that it would consider, in Case No. 2009-00124, whether it is appropriate to assess a separate charge for the KRA withdrawal fee.

Different utilities treat the KRA fee differently. As discussed above, Kentucky-American estimates its future Kentucky River withdrawals and annually adjusts the

⁸ Case No. 2006-00154, Tariff Filing of Kentucky-American Water Company to Revise the Kentucky River Authority Withdrawal Fee, at 4 (Ky. PSC Feb. 12, 2007).

⁹ *Id.* at 5-6.

¹⁰ Case No. 2007-00143, Adjustment of Rates of Kentucky-American Water Company (Ky. PSC Nov. 29, 2007); Case No. 2008-00427, Adjustment of Rates of Kentucky-American Water Company (Ky. PSC June 1, 2009).

withdrawal rate it charges its customers. It separates the KRA withdrawal rate from its general rate. Frankfort Electric and Water Plant Board also separates its wholesale rate from a KRA withdrawal rate but uses a historical test period to calculate the prospective KRA withdrawal rate. Other water utilities, such as the City of Nicholasville,¹¹ include the KRA withdrawal rate in their general volumetric rates.

The differing treatment of the KRA fee raises questions. As stated above, the Commission has previously implied that the fee should be considered a license, franchise, or similar fee or tax.¹² The Commission authorized the separate billing of franchise fees, reasoning that they represented a tax and that only persons residing in the municipality or governmental unit assessing the tax enjoyed the benefits from that tax and, therefore, should only be allocated the cost of that tax.¹³ Moreover, the franchise was unrelated to the actual provision of the utility service.

The Kentucky Court of Appeals, however, has since held that the KRA fee is not a tax because it does not support the government in general but, instead, is a special assessment because it has a direct relationship to a benefit received by the payer.¹⁴ This holding undercuts the proposition that the KRA fee is a license, franchise, or similar

¹¹ See Case No. 2008-00224, Application of the City of Nicholasville for Acceptance and Expedited Implementation of Adjustment to Its Wholesale Water Service Rate (Ky. PSC June 23, 2008).

¹² See *supra* note 4 and accompanying text.

¹³ Case No. 1989-00054, Taylor County Rural Electric Coop. Corp. Notice of Tariff Revision (Apr. 10, 1989); Case No. 7906, Local Taxes and/or Fees Tariff Filing of Columbia Gas of Kentucky, Inc. (Oct. 10, 1980).

¹⁴ *Kentucky River Auth. v. City of Danville*, 932 S.W.2d 374, 376 (Ky. Ct. App. 1996).

fee or tax. While a franchise fee is generally imposed by a local government on a geographically large utility and does not apply to utility customers located outside the government's territory, the KRA fee applies to all customers of a water utility that withdraws water from the Kentucky River basin. If the KRA fee is not a tax and is a cost incurred to serve all customers, the question arises as to why the fee should not be treated as other expenses that are incurred to provide water, such as power, chemical and labor costs, and recovered in general rates instead of separate line items.

Because our ultimate findings in this proceeding may have significant implications regarding the method that other utilities use to recover the KRA withdrawal fee, we find that all water utilities, public and municipal, that are subject to Commission jurisdiction and that are assessed a withdrawal fee by the KRA should be given notice of this proceeding and an opportunity to intervene and to submit written memoranda on this issue. We further find that notice of this proceeding should be given to the Attorney General.

IT IS HEREBY ORDERED that:

1. A copy of this Order shall be served on the parties of record and all persons listed in the Appendix to this Order.
2. Any person wishing to intervene in this case should file a motion to intervene with the Commission no later than August 31, 2009.
3. Any party to this case may file with the Commission, no later than September 30, 2009, a written memorandum on the following issues:

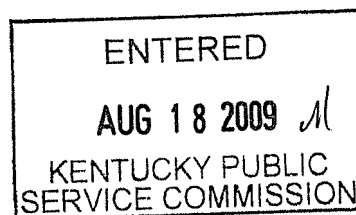
a. Should the fees that the KRA assesses for water withdrawals from the Kentucky River Basin be considered as a normal cost of providing water service and recovered through general rates only?

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?

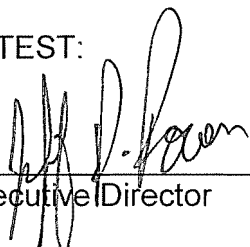
c. Whether use of a methodology that considers the fees that the KRA assesses for water withdrawals from the Kentucky River Basin as an extraordinary expense recoverable through a separate line item on customer bills and that ensures total recovery of such fees impedes Kentucky-American and other water utilities from implementing practices to reduce the volume of unaccounted-for water.

4. Any party wishing a hearing or oral arguments in this matter shall file its motion for such hearing or arguments with the Commission no later than October 7, 2009.

By the Commission



ATTEST:



Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2009-00124 DATED **AUG 18 2009**

Attorney General's Office of Rate Intervention

City of Beattyville

Berea Municipal Utilities

Bullock Pen Water District

City of Campton

City of Danville

Frankfort Electric and Water Plant Board

Harrodsburg Municipal Water Works

City of Hindman

Hyden-Leslie County Water District

Irvine Municipal Utilities

City of Jackson

City of Lancaster

City of Lawrenceburg

City of Manchester

City of Nicholasville

Richmond Utilities Board

City of Stanford

City of Versailles

City of Wilmore

Winchester Municipal Utilities

Honorable Lindsey W Ingram, III
Attorney at Law
STOLL KEENON OGDEN PLLC
300 West Vine Street
Suite 2100
Lexington, KY 40507-1801