

RECEIVED

Commonwealth of Kentucky
Before the Public Service Commission

OCT 31 2007

PUBLIC SERVICE
COMMISSION

In the Matter of:

EXAMINATION OF THE OPERATION AND)
REASONABLENESS OF THE OFFSETTING) Case No. 2006-00191
IMPROVEMENT CHARGE OF HENRY COUNTY)
WATER DISTRICT NO. 2)

BRIEF OF THE ATTORNEY GENERAL

Respectfully submitted,


GREGORY D. STUMBO
ATTORNEY GENERAL



David Edward Spenard
Assistant Attorney General
1024 Capital Center Drive, Suite 200
Frankfort, KY 40601-8204
502 696-5457

Certificate of Service and Filing

Counsel certifies that an original and ten photocopies of this Brief were served and filed by hand delivery to Beth O'Donnell, Executive Director, Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601; furthermore, it was served by mailing a true and correct of the same, first class postage prepaid, to D. Berry Baxter, 117 West Main Street, LaGrange, Kentucky 40031 (counsel for Henry County Water District #2) all on this 31st day of October, 2007.


Assistant Attorney General

The manner in which a utility assigns costs relating to system growth is not a new issue. While the issue has grown in recent years to include questions concerning source of supply development, treatment, storage, and transmission facilities,¹ we have been dealing with rate design issues relating to growth and the extension of service for a number of years.

807 KAR 5:066 contains the framework for the extension of service to an area without an existing distribution main. While, in theory, the Commission could adopt a policy through which the entire cost of the extension of the distribution main would fall upon either the prospective customer or the utility, the Commission has adopted the "50 foot" rule.²

To be clear: While the debate regarding system growth has expanded, we have been dealing with issues relating to charges as a condition of service for prospective customers for many years. The "50 foot" rule is a discretionary regulatory measure to balance the interest of current customers with prospective customers. It is a rule of fairness equally applicable, by virtue of the promulgation of a regulation, to a utility that seeks rate increases on a frequent basis as well as a utility that is hesitant to seek timely adjustments in rates.³ Given that rule is rooted solely in the Commission's powers under KRS 278.280

¹ And those questions are not at issue in this proceeding.

² 807 KAR 5:066 Section 11 (1).

³ TE (13 September 2007) pages 222 and 223.

relating to extensions of service, it is unremarkable that the application of the rule is without reference to general rates.

In PSC Case No. 2001-00393, the Commission authorized an Offsetting Improvement Charge for Henry County Water District No. 2.⁴ In summary, the OIC is a non-recurring charge for claiming available hydraulic capacity. The OIC is a condition of receiving service or obtaining a certification of water availability for property developments. While the charge is a condition of receiving service for new connections, the OIC is part of a framework that is separate from the District's main extension policy.

The focus of the OIC is upon the hydraulic impact of requests for service or certifications of water availability via the District's existing distribution facilities. Further, the District, through the OIC, does not seek to fund costs associated with facilities or projects such as source of supply development, treatment, and storage.⁵ The OIC is for funding projects relating to growth and the corresponding impact on the distribution system.⁶

Consequently, the District, through the OIC, is seeking fairness in balancing the interest of current customers with prospective customers in situations in which a distribution main is available (and in some instances only nominally available due to a lack of adequate capacity thereby rendering the area

⁴ Case No. 2001-00393, Order, 25 July 2002.

⁵ TE pages 140, 141; 143; 158; 235; and 242.

⁶ While, at times, the District refers to the OIC as funding transmission and distribution, the Office of the Attorney General believes that substance should prevail over form. The problem stems from inequity resulting from differences in "local" hydraulic conditions and relate primarily to distribution system consideration rather than transmission considerations.

the functional equivalent of an area without a distribution main).⁷ Thus, the OIC is regulatory measure akin to the “50 foot” rule; It seeks fairness through determining the equitable assignment of costs for a prospective customer.

The Office of the Attorney General supports the District’s proposal.⁸ The basis of the support is consequent to two results of the OIC. The OIC prevents a prospective customer from obtaining an indefinite cost-free “call option” on the hydraulic capacity of a portion of the distribution system to the detriment of existing customers and subsequent prospective customers; and The OIC promotes fairness between prospective customers in different parts of the District’s service territory.

The OIC is clearly a cost associated with the reservation of or claim upon hydraulic capacity.⁹ It places a cost on the prospective customers who, prior to the OIC, were able to obtain an indefinite cost-free “call option” on the hydraulic capacity of a portion of the distribution system or otherwise cost-free access to the hydraulic capacity of the system.

Prior to the OIC, if a person approached the District with a request for service or the certification of the availability of water service, the District would make a determination as to whether or not it had sufficient then-existing

⁷ TE pages 36 through 38; and 234.

⁸ The OAG’s support is not without condition. Specifically, the OIC may not be self-adjusting or contain a mechanism through which changes in the rate are made without a formal application to and authorization by the Commission. It is a non-recurring charge, and any change should be through the same process for changing any other non-recurring charge.

⁹ TE pages 36 and 37.

capacity.¹⁰ If the District had the capacity, then it would provide service or certify the availability of service; conversely, if the District did not have the capacity, then it would deny the request.¹¹

Prior to the OIC, if the District was unable to serve (or certify the availability of water to) the proposed development, the prospective customer paid for the “upsizing” or upgrade in order for the District to extend service.¹² For a prospective customer in an area of the District’s service territory in which there was “excess” hydraulic capacity, that customer paid nothing when applying for service (or certification).¹³ The District found the difference between the results inequitable.¹⁴

Further compounding the inequity is the scenario where the prospective customer takes the remaining hydraulic capacity without charge and a subsequent prospective customer (seeking service at the same general location in the distribution system) would have to pay the entire costs for an upgrade in order to obtain service. The fact of this inequity is known, and it provides an incentive for prospective customers to reserve as much available capacity as quickly as possible.¹⁵

¹⁰ TE (public hearing, 13 September 2007) pages 32 through 34; 35 through 37.

¹¹ TE pages 33 and 34; (The District’s position was that the request for service could not result in the District’s pressure falling below 30 psi.); Order, 22 May 2006; District’s Response to PSC 11 August 2006 Order, Item 4(c).

¹² TE pages 65, 66; and 234.

¹³ TE page 234.

¹⁴ TE page 33.

¹⁵ TE page 37.

The District, through the OIC, took action with the goal that all developers pay “equally.”¹⁶ For those who have projects that actually require upgrades, the prospective customer pays for the upgrade; for those who have projects that do not require upgrades (due to available capacity), that prospective customer pays an amount to offset the hydraulic impact of the project to the excess capacity.¹⁷ Through the OIC, each prospective customer pays an amount for the hydraulic impact consequent to growth. The OIC eliminates the cost-free reservation of hydraulic capacity.

Further, through the OIC, each prospective customer, regardless of location in the District’s service area, is required to pay an amount relating to the hydraulic impact of growth. There will be more consistency as between applications for service in different parts of the system.¹⁸ Two prospective customers in the same customer class requesting service should not be subject to different results in terms of the charges associated with obtaining service simply by virtue of the fact that they seek service at points in the system that have differing pressures. The OIC reduces such problems.

There has been a fair amount of discussion regarding whether “upsizing” or upgrading mains to accommodate growth results in benefits to the existing customer base. An increase in pressure is not necessarily a benefit, and, in fact, it

¹⁶ TE page 234.

¹⁷ TE pages 71 and 72.

¹⁸ See District Response to PSC 22 May 2006 Order, Item 20 (even a system with no net customer growth may have upsizing expense due to population shifts).

can be a detriment.¹⁹ Water quality is not necessarily improved due to a larger diameter of new lines.²⁰ On the whole, the record supports the position that any benefit to the existing customer base consequent to the OIC appears minimal if at all existent.²¹

While the Office of the Attorney General does not seek to minimize or otherwise discourage any concerns or issues relating to the District's "general" rates for water service or practices relating to depreciation, those areas are matters for either a separate application by the District or an investigation. For the utility that has ample resource, the goal of seeking fairness in its connection charges does not depend upon the general rates. For comparison, the necessity for a main extension policy is equally present in a utility that seeks rate adjustments each year as well as a utility that is hesitant to seek timely rate adjustments.²²

Nonetheless, the Attorney General notes that it is important to restrict the OIC to distribution system upgrades relating to growth²³ and not permit the OIC to fund main repair, rehabilitation, or replacement.

In Case No. 2001-00393, the Office of the Attorney General took the position that the OIC falls within the definition of a system development

¹⁹ TE page 216.

²⁰ District's Response to PSC Order of 11 August 2007, Item 3.

²¹ Any benefit in terms of existing customers only occurs in the growth portions of the project. TE page 169; Any benefits are incidental. See, for example, TE 169 and 193.

²² TE page 191 (the OIC and rates are separate issues); page 199 (review is independent)

²³ Hydraulic improvements undertaken to provide service. See District Response to PSC Order of 11 August 2007, Item #3; TE pages 167 and 168.

charge.²⁴ After further consideration, the OIC does not fit neatly under the SDC umbrella.²⁵ While it seeks to address some of the goals of an SDC such as maintaining balance between existing customers and “new” customers consequent to growth, it is a charge addressing local service main facilities necessary for extensions of service.

Furthermore, because this is clearly a request to deviate from the 807 KAR 5:090 framework, this is not a proposal that lends itself to any meaningful discussion of the theoretical “standard” System Development Charges (under either the equity or incremental methods) as contemplated by the 807 KAR 5:090. Additional debate and discussion on the respective virtues and vices of “standard” SDC’s should properly wait until this Commission is actually considering one. Accordingly, the Commission should abstain from using this case as a platform for addressing general policy considerations for SDC’s.

WHEREFORE, the Attorney General notes that, with modification, the Offsetting Improvement Charge proposal is a reasonable non-recurring charge with regard to conditions for receiving service. The Attorney General expressly limits his endorsement to this proposal, a framework for assigning the cost of hydraulic impacts to the distribution system attributable to growth to new and prospective customers.

²⁴ Case No. 2001-00393, Order, 25 July 2002, page 4.

²⁵ For example, the OIC is not for funding facilities such as new tanks or the expansion of treatment facilities.

Issues to address in written briefs

Pursuant to 5 January 2007 Order

1. Should the Commission consider the level of Henry County Water Districts No. 2's existing rates for general water service in determining the reasonableness of the Offsetting Improvement Charge proposal?

RESPONSE: Qualified Yes. As with any new non-recurring charges that impose or isolate costs upon individuals such as a return check charge or a tapping fee, the inquiry into the existing rates for general water service is relevant to the OIC proposal. Consider the following example: Hypothetical utility "A" does not charge a reconnect fee. The costs for reconnections is a real cost to the utility, and it is funded through "general" rates. If utility "A" seeks to establish a non-recurring charge for a reconnection, then it is clear that the utility will begin funding the costs through a separate charge rather than through "general" rates. To this extent, there is a need to consider the existing rates for general water service in order to determine if the isolation of the revenue collection via the fee produces a double-recovery and over-earning. It is a qualified yes because a utility's existing rates for general water service should not be a determining factor for whether a non-recurring charge is an appropriate charge. The impact on existing rates is a collateral or subsidiary consideration after (and only if there is) a Commission determination that the non-recurring charge is otherwise fair, just, and reasonable in terms of rate design.

2. Must a water utility be assessing rates for general service that fully recover the cost of providing water service as a condition to the assessment of a charge such as the OIC?

RESPONSE: Qualified No. A utility's existing rates should not be the determining factor for the inquiry of whether a new non-recurring charge merits approval. As noted in the previous response, the impact on existing rates is a collateral or subsidiary issue.

3. Is the use of the Offsetting Improvement Charge more equitable and reasonable and less administratively burdensome than the use of a fee based upon either the equity and incremental cost methodologies that the American Water Works Association recognizes?

RESPONSE: While the District is steadfast in its position that the OIC is a System Development Charge (and while the proposal does, in a general sense, fall within the scope of the definition of a SDC per 807 KAR 5:090 Section 1 (3)), the Office of the Attorney General does not view this as a true System Development Charge. The focus of the OIC is not common-use facilities (such as supply sources, source water intakes, etc.); rather, the focus of the OIC is upon local facilities (i.e. the distribution system). The OIC does not fall within the scope of a charge for which the equity or incremental cost methodologies are applicable. See American Water Works Association Manual of Water Supply Practices (AWWA M1 Fifth Edition). To this extent, this inquiry is no different from an inquiry as to whether a charge consequent to the District's main extension policy is more equitable and reasonable and less administratively burdensome than the use of a fee based upon the equity or incremental cost methodologies. The OIC and the SDC methodologies are not directly comparable in terms of equity and reasonableness. In terms of comparing non-recurring charges, the OIC appears to be far less administratively burdensome than an SDC.

4. (a) Is the assessment of a charge or fee such as the OIC reasonable when the water utility is experiencing significant growth?

RESPONSE: There is no direct relationship, *per se*, between growth and the need for the OIC. An OIC could be a reasonable charge for a "no growth" (in terms of customer count) system; likewise, it could be a reasonable charge in a system experiencing significant growth. Hence, the reasonableness of the charge does not depend upon growth.

- (b) If the assessment is dependent upon the water utility experiencing significant growth, then is Henry County Water District No. 2 experiencing such growth?

RESPONSE: Not applicable.

5. In examining the reasonableness of the OIC proposal, what consideration, if any, should the Commission give to the revenues that new customers will generate when they begin receiving water service?

RESPONSE: As with revenue under existing rates, revenue corresponding to new customers is a collateral or subsidiary consideration. The Commission should prevent any over-earning that could result from the OIC operating in tandem with existing rates.

6. Is the Henry County Water District's certification to a local planning and zoning commission of the availability of water service to unoccupied and unserved real estate tracts a proper basis for denying water service to applicants for water service who meet the published conditions of service and are ready to take such service?

RESPONSE: Henry County Water District No. 2 takes the position that it must comply with all applicable regulatory mandates regarding water pressure. The District further takes the position that it considers a certification of water availability equal in impact (with regard to hydraulic capacity) to an actual connection and use. (The District, at one point, compares hydraulic capacity to a checking account. As with money in a checking account that corresponds to an issued check not yet cashed, there is hydraulic capacity that corresponds to a certification of water availability. The District does not view hydraulic capacity that has been set aside or otherwise "accounted for" through a certification of service as available capacity for a separate request.) If the District fails to account for the "call option" on the hydraulic capacity of the system resulting from a certification of water availability, the District runs the risk of accepting too many customers. In determining whether to deny water service to an applicant, the District may properly take into consideration all of its existing commitments and obligations when determining if adequate hydraulic capacity is presently and will continue to be available.