

DEC 04 2019

PUBLIC SERVICE  
COMMISSION

**COMMONWEALTH OF KENTUCKY**  
**BEFORE THE PUBLIC SERVICE COMMISSION**

**In the Matter of:**

**APPLICATION OF KNOTT COUNTY WATER )  
AND SEWER DISTRICT FOR AN ) CASE NO. 2019-00268  
ALTERNATIVE RATE ADJUSTMENT )**

**LETCHER COUNTY WATER AND SEWER DISTRICT'S COMMENTS  
REGARDING THE FINDINGS AND RECOMMENDATIONS CONTAINED IN  
COMMISSION STAFF REPORT**

Pursuant to the Public Service Commission's ("Commission") Order of August 14, 2019, Letcher County Water and Sewer District ("Letcher District") submits the following comments regarding the findings and recommendations contained in the Commission Staff Report. As to those issues that are not specifically addressed in these Comments, Letcher District reserves the right to present evidence and argument on those issues and to make objections to and present evidence on any finding or recommendation contained in the Report should an evidentiary hearing on Knott County Water and Sewer District's ("Knott District") application be held in this matter.

**COMMENTS**

**Pro Forma Revenues from Sales for Resale.** Commission Staff found that Knott County Water and Sewer District's ("Knott District") pro forma revenues from sales for resales was \$1,115,640. Commission Staff made no adjustment to sales for resales to reflect 11,000,000 gallons of water that Knott District delivered to Letcher District in the test period but did not bill for due to a defective meter.<sup>1</sup> Knott District acknowledges that, but for the defective meter and provisions of its wholesale contract with Letcher District limiting its right to back bill for these amounts, Knott District would have reported additional sales of 11,000,000 of water and received

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<sup>1</sup> Knott District's Response to Letcher District and the City of Hindman's First Request for Information, Item 30.

\$33,000 in revenue from these sales.<sup>2</sup> As the defective meter has been repaired and as adjustments to test-period operations should be made to reflect known and measurable changes, the recommended pro forma revenues from sales for resales should be increased to \$1,148,640.

**Provision of Free Water Service to Sewer Division.** Knott District reported in its 2018 Annual Report that 2,400,000 gallons of water was provided to its Sewer Division at no charge.<sup>3</sup> Commission Staff did not address this provision of free water in its Report. The Commission, however, has previously found that, while a water utility may provide free service, “revenue must be imputed for that free service in determining the wholesale rates for sales to Commission regulated utilities to ensure that the wholesale customers are not paying for that free service.”<sup>4</sup> Assuming that the Sewer Division were charge for the water at the current wholesale rate, Knott District’s pro forma total operating revenues should be increased by \$7,200.

**Capitalization of Expenses Associated with Tap Fees.** Commission Staff recommends that test-period Salaries and Wages - Employees and Materials and Supplies be reduced to reflect the capitalization of tap fee expenses. The recommended level of this reduction appears based upon the assumption the labor and material expenses to perform taps during the test-period is equal to the revenues generated by tap fees assessed during the test period. While expenses associated with these taps should be capitalize, the record contains no evidence to support the assumption that tap fee revenue equals the costs to perform taps. To the contrary, the tap fees currently assessed were placed into effect over twelve years and are likely no longer representative of actual costs. In response to discovery requests, Knott District concedes that the cost of making a tap exceeds

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<sup>2</sup> Knott District’s Response to Letcher District and the City of Hindman’s Second Request for Information, Item 20.

<sup>3</sup> Knott District 2018 Water Annual Report at Ref Page 30. In a response to a discovery request, Knott District sought to dismiss the suggestion that water was provided to its sewage treatment facilities and suggested that the primary use of the water was for line flushing. See Knott District’s Response to Letcher District and the City of Hindman’s First Request for Information, Item 29. If this was the purpose of the water’s use, then the usage should have been reported as usage for system flushing. It was not.

<sup>4</sup> *Electronic Proposed Adjustment of the Wholesale Water Service Rates of Lebanon Water Works*, Case No. 2017-00417 (Ky. PSC July 12, 2018) at 10.

the \$600 of revenue that a tap fee generates.<sup>5</sup> There is no evidence that the assumptions Knott District used in 2007 to develop its tap fee are still valid. Commission Staff has found that Knott District has failed to maintain records to accurately determine the cost of making a tap<sup>6</sup> but elected not to undertake its own estimate of this non-recurring activity's cost. At a minimum, the Commission should require Knott District to review its costs and update its tap fee to reflect current costs.<sup>7</sup>

**Allocation of Commissioner Salaries to Sewer Division.** In its Application, Knott District failed to allocate any Commissioner salaries to its Sewer Division. In its Report, Commission Staff recommended 5.35 percent or \$1,615 of commissioner salaries be allocated to the Sewer Division based upon the number of customers that each Division served.<sup>8</sup> The Commission rejected this approach in Knott District's last general rate proceeding and instead allocated the cost equally between its Water and Sewer Divisions.<sup>9</sup> Such approach is the more appropriate as each commissioner's legal duties and responsibilities to each division and its customers do not vary based upon the number of customers the division serves.

**Employee Health Insurance Benefits.** In its Application, Knott District sought to recover the total cost of health insurance benefits provided to its employees. Knott District pays total cost of single employee health insurance coverage and pays no less than 80 percent of the cost of other employee health insurance coverages. It also provides employees who do not obtain their health

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<sup>5</sup> Knott District's Response to Letcher District and the City of Hindman's Second Request for Information, Item 19.

<sup>6</sup> Commission Staff Report at 8.

<sup>7</sup> None of Knott District's non-recurring charges have been revised since 2007. The Commission should consider reviewing all of those charges to determine if adjustments are required to ensure they accurately reflect the current cost of providing those non-recurring services.

<sup>8</sup> *Id.* At 8-9.

<sup>9</sup> *The Application of the Knott County Water and Sewer District for A Rate Adjustment Pursuant to the Alternative Rate Filing Procedure for Small Utilities*, Case No. 2002-00292 (Ky. PSC May 23, 2003) (adopting the recommendations contained in Commission Staff Report of April 29, 2003). In its Report in Case No. 2002-00292, Commission Staff found "it is more equitable to divide this expense evenly between Knott District's two divisions rather than by using the proposed customer allocation method." Commission Staff Report, Attachment E at 6.

insurance coverage through the Water District with additional annual compensation of \$8,394 (“insurance credit”) in lieu of receiving insurance coverage.<sup>10</sup>

The Commission has found that any portion of utility payments for employee health insurance coverage that exceed 79 percent of the total cost for single employee health insurance coverage or 67 percent of the total cost for family health insurance coverage is unreasonable and should not be recovered through rates.<sup>11</sup>

In its Report, Commission Staff recommended that the Commission disallow \$9,258 of Knott District’s employee health insurance costs to reflect the Commission’s policy that utility employees should be required to contribute to their health insurance costs at the same level as the national average found in Bureau of Labor Statistics studies.<sup>12</sup> Commission Staff, however, failed to show the actual calculations used to determine the level of the recommended disallowance. In its Report, Commission Staff suggests that the employer contribution rates established by the Kentucky Employees Health Plan were used instead of the national averages reported by the Bureau of Labor Statistics.<sup>13</sup> The Commission should require Commission Staff to publish its calculations and, if Commission Staff failed to use the national averages reported by the Bureau of Labor Statistics, recalculate the disallowance using the national averages.

Any disallowance of employee health insurance costs should also consider the insurance credit provided to employees who elect to forego insurance coverage from Knott District and that

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<sup>10</sup> See Knott District’s Response to Letcher District and the City of Hindman’s First Request for Information, Items 13 and 14; Knott District’s Response to Letcher District and the City of Hindman’s Second Request for Information, Item 16.

<sup>11</sup> See, e.g., *Electronic Proposed Adjustment of the Wholesale Water Service Rates of Lebanon Water Works*, Case No. 2017-00417 (Ky. PSC July 12, 2018); *Electronic Application of West Carroll Water District for Rate Adjustment*, Case No. 2017-00244 (Ky. PSC Apr. 24, 2018); *Electronic Application of Monroe County Water District for Rate Adjustment Pursuant To 807 KAR 5:076*, Case No. 2017-00070 (Ky. PSC Jan. 12, 2018).

<sup>12</sup> Commission Staff Report at 10-11

<sup>13</sup> *Id.* at 11 (“Factoring in for the preceding, Staff decreased employee pensions and benefits to match the amount contracted with KEHP . . .). The Commission has previously rejected arguments that the Kentucky Employees Health Plan’s employer contribution rates should be used to establish the reasonableness of employer health insurance benefit costs. See *Electronic Application of Monroe County Water District for Rate Adjustment Pursuant To 807 KAR 5:076*, Case No. 2017-00070 (Ky. PSC Jan. 12, 2018).

is based upon the cost of single employee insurance coverage. Knott District has reported that three of its employees receive the insurance credit. Neither Knott District nor Commission Staff has explained why compensating an employee who voluntarily elects to forego an employee benefit is reasonable. Should the Commission determine such action is reasonable, Knott District should be permitted to recover only 79 percent of the insurance credit through its rates.

**Depreciation Expense.** Knott District proposes to calculate its depreciation expense using the mid-point of the range of useful lives found in *Depreciation Practices for Small Utilities*, a publication of the National Association of Utility Regulatory Commissions (“NARUC”). Commission Staff found “no evidence to support depreciable lives that vary significantly from the mid-point of the NARUC ranges”<sup>14</sup> and accepted this proposal. In calculating pro forma depreciation expense, Commission Staff used for Knott District’s water mains and water treatment plant a useful life of 62.5 years and 37.5 years respectively.

Commission Staff, however, did not considered several relevant points in reaching its finding. The NARUC Study was published in 1979 and is based upon depreciation studies of larger utilities performed in the 1970s. As such, the NARUC Study reflects the asset lives of facilities built and placed into service from 1900 to 1978 and does not reflect the advancements in technology, construction and engineering that have occurred in the last forty years. The Commission has noted favorably in its decisions to studies that show that water mains made of polyvinyl chloride, a piping material not in great use in the 1970s but now widely used, has a useful life of 100 years.<sup>15</sup> With regard to its water treatment plant and most of its water mains and lines, Knott District’s facilities have been constructed and placed into service within the last fifteen

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<sup>14</sup> Commission Staff Report at 15.

<sup>15</sup> See *Electronic Application of Monroe County Water District for Rate Adjustment Pursuant To 807 KAR 5:076*, Case No. 2017-00070 (Ky. PSC Jan. 12, 2018) at 9. Commission Staff was a proponent of this study and introduced it as evidence into the record of that proceeding.

years, many within the last ten years. As a result, they are products of the most recent technology and engineering advances and are likely to have a useful life consistent with the uppermost range of useful lives found in NARUC Study – 40 years for the water treatment facilities and 75 years for water mains.

Use of the uppermost range of useful lives is consistent with Commission precedent. For example, in Case No. 2012-00413,<sup>16</sup> the Commission applied a 75-year useful life to determine the depreciation expense for a water district's water mains based upon the material composition of the water district's water mains and the low incidence of water loss. In recommending the longer useful life, Commission Staff stated:

[T]he majority of Pendleton District's transmission and distribution main is made of PVC and ductile iron. These materials are very durable and can maintain their structural integrity for more than 100 years. Pendleton's District's mains are thought to be free of material decay as evidenced by the 5 percent water loss reported in its 2011 annual report. This percentage is well below the 15 percent allowed by regulation and warrants a depreciable life for mains that falls toward the outer limit of the NARUC range.<sup>17</sup>

Knott District's water loss for the test period is nine percent – also well below the regulatory permissible standard of 15 percent.<sup>18</sup>

Use of the uppermost range of useful lives for water mains and water treatment facilities would result in a reduction of \$94,321 in pro forma depreciation expense.

**Calculation of Debt Service Expense and Working Capital.** Commission Staff recommended that Knott District be permitted to recover its average annual principal and interest payments on its long-term indebtedness based on a five-year average of its annual principal and

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<sup>16</sup> *Application of Pendleton County Water District for an Adjustment in Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities*, Case No. 2012-00413 (Ky. PSC Dec. 20, 2012).

<sup>17</sup> Commission Staff Report, Attachment A at 10 (Oct. 29, 2012) filed in *Application of Pendleton County Water District for an Adjustment in Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities*, Case No. 2012-00413 (Ky. PSC filed Sept. 10, 2012).

<sup>18</sup> Knott District 2018 Water Annual Report at Ref Page 30.

interest payments for the years 2019 through 2023. It calculated this average as \$60,735. It further recommended that Knott District be allowed an allowance for working capital that is equal to 120 percent of its average annual long-term debt payments, or \$12,147.

Knott District has already made the principal and interest payments on its long-term debts for 2019.<sup>19</sup> Those payments have been recovered through the water district's existing rates. Only debt service payments that will be made after new rates are effective should be considered in determining Knott District's debt expense. Otherwise the rates will not accurately reflect the cost of service. Accordingly, debt service expense should be based upon the average of debt service payments for the period from 2020 to 2024. If this average is used, the debt service expense is \$47,732 and the allowance for working capital is \$9,547. This calculation is shown in the table below.

Year	RD Bonds 2003		RD Bonds 2007		KIA Loan			Total
	Principal	Interest	Principal	Interest	Principal	Interest	Fee	
2020	\$3,500	\$6,683	\$1,600	\$3,929	\$ 58,971	\$ 5,070	\$250	\$ 80,004
2021	\$3,500	\$6,625	\$1,700	\$3,857	\$ 61,404	\$ 2,637	\$130	\$ 79,753
2022	\$4,000	\$6,368	\$1,800	\$3,780	\$ 31,646	\$ 375	\$ 19	\$ 47,987
2023	\$4,000	\$6,188	\$1,800	\$3,699	\$ 0	\$ 0	\$ 0	\$ 15,687
2024	\$4,000	\$6,008	\$2,000	\$3,518	\$ 0	\$ 0	\$ 0	\$ 15,226
Total								\$238,657
Average Annual Debt Service ( $\$238,657 \div 5$ years)								\$ 47,732
Working Capital (Annual Debt Service x 0.2)								\$ 9,547

<sup>19</sup> Knott District has long-term loans with Rural Development and the Kentucky Infrastructure Authority. Payments for Rural Development loans are made on January 1 and July 1. Payments on its Kentucky Infrastructure Authority loan are made monthly. Knott District's Response to Letcher District and the City of Hindman's Second Request for Information, Item 5.

## SUMMARY

Letcher District requests that the Public Service Commission in rendering its decision on Knott District's proposed rate adjustment carefully consider these comments and accord them the appropriate weight.

Dated: December 4, 2019

Respectfully submitted,

A handwritten signature in blue ink, reading "Gerald E. Wuetcher", written over a horizontal line.

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## CERTIFICATE OF SERVICE

In accordance with 807 KAR 5:001, Section 8, I certify that on December 4, 2019 a true and accurate copy of this Notice was transmitted by electronic mail to the following:

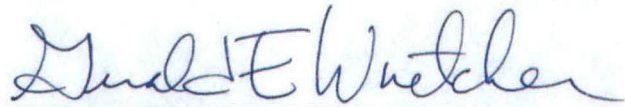
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