

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

In the Matter of:

Application of Water Service Corporation )  
of Kentucky for a General Adjustment ) Case No. 2020-00160  
in Existing Rates )

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**RESPONSE BRIEF OF  
WATER SERVICE CORPORATION OF KENTUCKY**

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In this case, Water Service Corporation of Kentucky (“WSCK”) seeks an increase in rates for water service. It also seeks approval of certain tariff amendments, including the addition of a qualified infrastructure plan, a leak adjustment policy, a low-income rate, and a wholesale rate.

On November 23, 2020, the Attorney General filed its initial brief. Intervenor City of Clinton did not file a brief. The following brief responds to the arguments presented by the Attorney General.

**I. WSCK’s proposed residential monthly customer charge is reasonable.**

WSCK proposes to increase its monthly customer service charge approximately 38%, which is approximately the same as the overall percentage increase for WSCK’s proposed annual revenue requirement. Without presenting any testimony or support, the Attorney General argues that the increase in customer charge should be phased in over a period of time. The Attorney General argues that “[a]n increase of this magnitude to the residential charge will hinder the residential customers’ ability to control their monthly bills and will pose a financial hardship on

those customers who are already struggling to make ends meet.”<sup>1</sup> The Attorney General suggests that a phased-in approach will “provide an opportunity for Water Service Kentucky’s customers to absorb the higher monthly charge over the course of a longer period of time.”<sup>2</sup> There are several flaws with the Attorney General’s argument.

First, the Attorney General has not presented any evidence to support this argument. In a recent case, the Commission explained that when intervening parties submit data requests to parties but offer no evidence or testimony on those issues, the Commission has no evidentiary basis to support the intervening parties’ proposed adjustments to the utility’s case.<sup>3</sup> In such a situation, the Commission has approved the utility’s proposals.<sup>4</sup> Accordingly, the Commission does not have any basis to accept the Attorney General’s adjustment to the customer charge.

Second, the Attorney General’s proposed phased-in approach does not produce benefits as substantial as the Attorney General suggests. By reducing the monthly customer charge collected by the utility, the volumetric charge must increase in order to ensure that the utility has the opportunity to recover its revenue requirements.<sup>5</sup> When factoring the necessary increase to volumetric rates if the Attorney General’s proposal were accepted, there would be a difference of less than one dollar to the average residential customer’s monthly bill during the proposed first phase. In contrast, WSCK’s proposed low-income rate that the Attorney General opposes would reduce average monthly bills by more than five dollars for qualifying customers. If the Attorney

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<sup>1</sup> Attorney General’s Brief at 3.

<sup>2</sup> *Id.*

<sup>3</sup> See *Kentucky-American Water Co.*, Case No. 2018-00358 (Ky. PSC June 27, 2019)(“The Commission notes that the Attorney General and LFUCG submitted data requests to Kentucky-American regarding the chemical complex but offered no evidence or testimony regarding the ratemaking treatment of the chemical complex. The Commission’s findings must be supported by sufficient evidence. Here, with no evidentiary support in the record regarding the proposed adjustment, the Commission is without any basis, much less sufficient evidence, to justify an adjustment, and therefore we deny LFUCG’s proposed adjustment to remove expenses related to constructing the chemical complex.”)

<sup>4</sup> *Id.*

<sup>5</sup> The cases cited by the Attorney General acknowledge that the volumetric rate must increase when the fixed rate decreases. See *Kentucky Power Co.*, Case No. 2014-00396 (Ky. PSC June 22, 2014); *Louisville Gas & Elec. Co.*, Case No. 2000-00080 (Ky. PSC Sept. 27, 2000).

General was genuinely concerned about any “financial hardship on those customers who are already struggling to make ends meet,” the Attorney General would support WSCK’s proposed low-income rate.

Third, WSCK operates in a mostly fixed-cost business. As such, the utility should be allowed to use a rate structure that resembles the fixed-cost environment in which it operates. WSCK’s as-filed income statement shows that 88% of the per books test year costs on its income statement are fixed, as compared to a current rate structure that only enables WSCK to collect 36% of revenues through fixed charges. When rate design is weighted more towards volumetric recovery, WSCK is at risk of not being able to recover the revenue requirement due to consumption and customer decline (-.44% and -.50% respectively).<sup>6</sup>

For these reasons, the Commission should accept WSCK’s proposal to increase the residential monthly customer charge.

**II. The Commission should approve WSCK’s approach to calculating revenue requirement based on an operating margin in this case.**

WSCK proposes to base its revenue requirements on an operating ratio, which has been encouraged and approved by this Commission in prior WSCK cases. In its brief, the Attorney General repeats the testimony of its witness, Lane Kollen.<sup>7</sup> WSCK addressed each of these arguments in its Initial Brief, and accordingly, adopts and incorporates each of WSCK’s statements in its Response. Most significantly, there is no evidence in this case on which Kollen or anyone else can determine what a reasonable return on equity would be. Not only is there no analysis commonly used to support a specific ROE—such as the discounted cash flow model (DCF), the capital asset pricing model (CAPM), the empirical CAPM (ECAPM), or risk premium (RP) models—Kollen even confirmed that there was no “firm-specific or sector-

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<sup>6</sup> WSCK Response to Staff 1-29.

<sup>7</sup> Attorney General’s Brief at 4-6.

specific information underlying the 50 basis point decrement,” stating “I didn’t actually do a study.”<sup>8</sup> Accordingly, there is insufficient evidence to utilize a rate base/rate of return methodology for calculating the revenue requirement in this case.

As WSCK President Steven Lubertozi indicated in his answers to the Vice Chairman’s questions, WSCK does not object to moving to a rate base/rate of return methodology in future cases.<sup>9</sup> If the Commission encourages WSCK’s future use of rate base/rate of return methodology, WSCK will have the opportunity to present adequate evidence to support an appropriate rate of return.

### **III. Miscellaneous Expenses**

The Attorney General identifies portions of several “miscellaneous expenses” that it believes should be removed from the as-filed revenue requirements. WSCK has agreed to many of these adjustments. Specifically, a reduction to the expenses associated with the hydrant maintenance, vehicle depreciation, tank rehabilitation project, and rate case expense is appropriate, as discussed in WSCK’s Initial Brief.<sup>10</sup>

The Attorney General encourages the Commission to reduce the as-filed revenue requirements by the expenses related to Project Phoenix and JD Edwards,<sup>11</sup> which amount to \$28,618.<sup>12</sup> WSCK included this depreciation expense in this case because the Commission determined that computer expenses should be depreciated over 22.5 years in Case No. 2018-00208. Accordingly, it is reasonable to include these expenses in WSCK’s revenue requirements.

The Attorney General also suggests that the Commission determine whether WSCK’s FUSION business intelligence asset is beneficial to WSCK customers. FUSION is an Oracle

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<sup>8</sup> VR: Nov. 12, 2020 at 18:39:50.

<sup>9</sup> See also Lubertozi Rebuttal at Q23.

<sup>10</sup> WSCK’s Initial Brief at 14-16

<sup>11</sup> Attorney General’s Brief at 8

<sup>12</sup> WSCK Response to AG 2-8(c).

cloud-based multi-functional platform which integrates payroll, time entry, recruiting, onboarding, performance management, benefits administration, human capital management, health and safety incident tracking, accounting, procurement, expense management, payment processing, vendor management and project management systems into a single, integrated platform.<sup>13</sup> Each of these functions directly benefits WSCK's customers.<sup>14</sup>

The Attorney General has not presented any evidence challenging the benefits of FUSION. As discussed above, the Commission has previously determined that, when intervening parties submit data requests to parties but offer no evidence or testimony on those issues, the Commission has no evidentiary basis to support the intervening parties' proposed adjustments to the utility's case.<sup>15</sup> In such a situation, the Commission has approved the utility's proposals.<sup>16</sup> Accordingly, the Commission does not have any evidentiary basis to reject FUSION expenses in rates.

In addition, there is a strong argument that the FUSION expenses be depreciated over 8 years, instead of 22.5 to ensure that customers who do not directly benefit from the asset in 20 years will be required to pay a portion of the cost of that asset. A more appropriate depreciation rate would be based on a service life of 8 years.

#### **IV. WSCK's wholesale water rate of \$2.214 is fair, just and reasonable.**

The Attorney General recommends that WSCK's wholesale rate be set at \$2.214 per 1,000 gallons, "if not higher." WSCK does not object to a higher wholesale rate. But that

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<sup>13</sup> Guttormsen Direct Testimony at 11-13.

<sup>14</sup> *Id.*

<sup>15</sup> *See Kentucky-American Water Co.*, Case No. 2018-00358 (Ky. PSC June 27, 2019) ("The Commission notes that the Attorney General and LFUCG submitted data requests to Kentucky-American regarding the chemical complex but offered no evidence or testimony regarding the ratemaking treatment of the chemical complex. The Commission's findings must be supported by sufficient evidence. Here, with no evidentiary support in the record regarding the proposed adjustment, the Commission is without any basis, much less sufficient evidence, to justify an adjustment, and therefore we deny LFUCG's proposed adjustment to remove expenses related to constructing the chemical complex.")

<sup>16</sup> *Id.*

adjustment will have no impact on the rates to other customers because there is no wholesale usage in the test year, nor is there any other reasonable and reliable anticipation of sales in the future.

**V. WSCK's proposed low-income rate is reasonable.**

The Attorney General has stated its “concerns” for WSCK’s proposed low-income rates. First, the Attorney General is concerned that the eligibility guidelines set an arbitrary standard between those customers earning below the poverty line and those customers earning one dollar above the federal poverty line. This standard, however is published by the Department of Health and Human Services, and is used to determine eligibility for certain federal and state assistance programs, such as housing vouchers, Medicaid, CHIP, and the Governor’s Health at Home Utility Relief Fund established under Executive Order 2020-881. If the federal poverty line were determined to be arbitrary, these significant assistance programs would crumble.

Second, the Attorney General questions whether a low-income rate would violate KRS 278.170(1), but refrains from reaching a conclusion to that question. In *Public Service Com'n of Kentucky v. Commonwealth*, 320 S.W.3d 660, 667 (Ky. 2010), the Court determined that the Commission’s approval of an economic development rate, under which customers receive a discount to cost-based rates, was both reasonable and lawful. The Court directly rejected the argument that KRS 278.170(1) prohibited utility customers from receiving reduced rates, so long as those customers fit within a reasonable classification. “To conclude otherwise would involve rendering both KRS 278.170(1) and KRS 278.030 largely meaningless.”<sup>17</sup>

KRS 278.170(4) also explicitly states that the Commission “may determine any question of fact arising under this section.” There should be little question that the Commission has the authority to determine that a low-income classification is reasonable.

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<sup>17</sup> *Public Service Com'n of Kentucky v. Commonwealth*, 320 S.W.3d 660, 668 (Ky. 2010).

## **VI. WSCK's Qualified Infrastructure Plan should be approved**

The Attorney General recommends denying WSCK's proposed qualified infrastructure plan ("QIP") based on an argument that WSCK has low water-loss percentages and that WSCK only anticipates replacing one mile of pipeline every calendar year. These arguments should fall on deaf ears.

It would be illogical for the Commission to consider WSCK's water loss percentage in determining whether WSCK should receive approval for a QIP. If the Commission were to deny a QIP on the grounds that a utility does not have excessive water loss, it would send the wrong signal to water utilities across the Commonwealth. Those water utilities may become complacent and allow their water loss to creep above the 15-percent threshold identified in 807 KAR 5:066, Section 6(3).

In addition, the Attorney General has not presented any evidence to support its argument that WSCK's replacement of one mile of main annually is insufficient to justify a QIP surcharge. WSCK has approximately 101 miles of main in its system.<sup>18</sup> By having a specific program designed to replace approximately one percent of its mains each year, WSCK can reasonably maintain its infrastructure in a routine and systematic way, while still addressing emergency concerns that arise. If WSCK proposed to replace more of its mains annually, the Attorney General would undoubtedly argue that such a replacement program is excessive and unnecessary.

The Attorney General also indicates that, if WSCK's proposed QIP is approved, there should be a reasonable cap on the allowed costs that will flow through the QIP. WSCK submits

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<sup>18</sup> WSCK 2019 Annual Report on file with the Public Service Commission, *available at* [https://psc.ky.gov/UFR\\_PDF/Water/2019/6000800\\_Water\\_Service\\_Corporation\\_of\\_Kentucky.pdf](https://psc.ky.gov/UFR_PDF/Water/2019/6000800_Water_Service_Corporation_of_Kentucky.pdf). In contrast, Kentucky-American Water Company has over 2,000 miles of main. *Kentucky-American Water Co.*, Case No. 2018-00358 at 73 (Ky. PSC June 27, 2019).

that any reasonable limitation can be addressed in the Commission proceedings establishing the QIP surcharge.

**VII. WSCK's post-test year adjustments are reasonable and should be included in its revenue requirements.**

The Attorney General maintains that “all costs associated with two new vacant positions from the requested rate increase, as well as any other post-test year adjustment that falls outside of the test year, that are not properly known and measurable” should be excluded from the revenue requirements.<sup>19</sup> Specifically, the Attorney General maintains that expenses related to the (1) Vice President of Regulatory Affairs and Business Development and (2) Midwest Project Manager should be excluded. WSCK anticipates that these two positions will be filled by the end of the year. Accordingly, it is appropriate to include these salaries in WSCK's revenue requirement.

The Attorney General has not identified any other post-test year expenses that should not be recovered in rates. Moreover, it has not presented any evidence that other post-test year expenses are not appropriate for recovery in rates. Accordingly, no adjustment to post-test year expenses should be made.

**VIII. WSCK's salaries and benefits are reasonable.**

Without providing any testimony or other evidence in the record, the Attorney General argues that the Commission should evaluate the reasonableness of WSCK's salary and benefit expenses.<sup>20</sup> The Attorney General does not even recommend exclusion of those expenses.

At most, the Attorney General points to WSCK's average salary increases in 2017 and 2018, arguing that WSCK “appeared to provide unreasonable average raises.”<sup>21</sup> In addition to

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<sup>19</sup> Attorney General Brief at 14.

<sup>20</sup> *Id.* at 14-16.

<sup>21</sup> *Id.* at 15.

the fact that the Attorney General did not present any evidence to support its argument, there is one primary flaw in this argument. It fails to recognize that these same salary increases have already been approved by the Commission as part of WSCK's revenue requirement in the Company's last rate case.<sup>22</sup> Accordingly, the Commission should likewise approve WSCK's inclusion of salary and benefit expenses in its revenue requirement.

## **IX. Conclusion**

WSCK has met its burden of proof in this case with the appropriate modifications noted above. Accordingly, WSCK requests the Commission approve an increase in rates, as well as approve the qualified infrastructure plan, a leak adjustment policy, a low-income rate, and a wholesale rate.

Respectfully submitted,



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<sup>22</sup> *Water Service Corp. of Kentucky*, Case No. 2018-00208 (Ky. PSC Feb. 11, 2019).