

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

**In the Matter of:**

<b>ELECTRONIC APPLICATION OF</b>	)	
<b>MCCREARY COUNTY WATER DISTRICT</b>	)	<b>CASE NO. 2021-00300</b>
<b>FOR AN ADJUSTMENT OF ITS SEWER</b>	)	
<b>RATES PURSUANT TO 807 KAR 5:076</b>	)	

**RESPONSE OF MCCREARY COUNTY WATER DISTRICT  
TO COMMISSION STAFF REPORT**

McCreary County Water District (“McCreary District”) submits its Response to the Commission Staff Report (“Staff Report”) on McCreary District’s application for an adjustment of its rates for sewer service.

Except as noted below, McCreary District accepts for purposes of this proceeding the findings set forth in the Staff Report and does not request a hearing on those findings or a conference with Commission Staff. Acceptance of those findings does not constitute agreement with those findings nor does McCreary District waive its right to contest or dispute those findings in future proceedings. As to the findings to which it takes exception, McCreary District does not request a hearing or a conference with Commission Staff, but requests that the Public Service Commission (“PSC”) consider the argument and evidence set forth in this Response in rendering its decision on the McCreary District’s Application.

**Exceptions to Findings**

Level of Increase. McCreary District respectfully requests that the PSC reject Commission Staff’s recommendation that sewer service rates be increased 42.76 percent in two phases over one year. In making its recommendation, Commission Staff gave little consideration to the detrimental effects of such a large and rapid increase of rates on McCreary District’s customers or to McCreary

District's efforts to expand its customer base. McCreary District requests that the PSC instead limit the adjustment of sewer rates to an immediate 16.38 percent increase that will generate additional revenues of \$211,617 and permit McCreary District to operate with a positive cash flow and comply with the requirements of its debt agreements.

Implementation of the Commission Staff recommended rates will impose significant hardship on many of McCreary District's customers. McCreary County has a median household income of \$29,499.<sup>1</sup> Approximately 36.2 percent of its households have incomes below the poverty level established by the Federal Government.<sup>2</sup> If Commission Staff's recommended rates are approved, the monthly bill for sewer service for an average McCreary District customer will increase from \$41.07 to \$58.63. When combined with the Commission Staff-recommended water rates, an average McCreary District customer will pay \$101.31 monthly for water and sewer service.

The recommended rates will also limit McCreary District's efforts to attract customers and expand sewer service. While McCreary County Fiscal Court has adopted an ordinance mandating connection to McCreary District's sewer system when it becomes available in a property owner's area, the property owner retains the right to continue using its existing septic system until system failure. Higher sewer rates discourage property owners from connecting to McCreary District's sewer facilities prior to such failures. Only by increasing the number of customers can McCreary District achieve the economies of scale necessary to maintain sewer rates at affordable levels. The significant increase recommended by Commission Staff is very likely to discourage property

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<sup>1</sup> Census Bureau, Quick Fact McCreary County, Ky., <https://www.census.gov/quickfacts/mccrearycountykentucky> (last visited Apr. 4, 2022).

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

owners from connecting to McCreary District's sewer facilities and likely lead to additional rate increases as increasing costs are spread over a stagnant customer base.

Increasing the number of customers is necessary not only to ensure the financial viability of McCreary District's sewer operations, but to address potential environmental and public health problems. According to the U.S. Census Bureau, there are approximately 6,187 households in McCreary County. Only about one-fifth of these households are connected to McCreary District's sewer collection system. The remaining households use septic systems. The existing soil conditions in McCreary County do not favor septic lines or septic systems. Septic system failures are occurring that result in contaminants leaching into the soil and the water table and creating public health and environmental problems.

Commission Staff's recommendation does not consider two recent developments that are likely to improve McCreary District's financial condition. McCreary District is nearing completion of its Sanitary Sewer Collection System Phase I Project. It estimates that the project will eventually add 305 customers to its sewer operations and at least 100 customers in the short term. These additional customers will generate additional annual revenues of \$57,348 if a 16.38 percent increase is implemented. Fibrotex USA, one of McCreary District's largest customers, is expanding its operations by the end of 2022 and expects to double its production output and to double its current purchases of water. Based upon its test period purchases, Fibrotex USA will increase its annual purchase of water and its annual output of wastewater by approximately 5,700,000 gallons. This increased output of wastewater will generate additional annual revenue of approximately \$49,761.<sup>3</sup>

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<sup>3</sup> 5,700,000 gallons x \$8.73 per 1,000 gallons = \$49,761.

The PSC has consistently held that a utility may choose to assess rates that do not produce a level of revenues that accepted ratemaking methodologies would regard as sufficient or adequate so long as the quality of the utility's service will not decline or be degraded as a result of the lower revenue level.<sup>4</sup> That holding is applicable in the current proceeding in which there is no evidence in the record to suggest that the quality of McCreary District's sewer service will suffer if an immediate 16.38 percent increase in rates is authorized instead of the 42.76 percent increase that Commission Staff recommends.

A 16.38 percent increase provides McCreary District sufficient revenues to meet its operating expenses, debt service payments, and debt service coverage requirements and still provide a positive cash flow. Based upon Commission Staff's findings, a 16.38 percent increase will produce total operating revenues of \$1,557,651.<sup>5</sup> McCreary District's total cash operating expenses and debt service requirements are \$1,304,094,<sup>6</sup> leaving McCreary District with a positive cash flow of \$253,557.<sup>7</sup> This amount is well in excess of the coverage requirement of McCreary District's bonded debt, which is 20 percent or \$41,997.<sup>8</sup> While a 16.38 percent increase will not

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<sup>4</sup> See, e.g. *Electronic Application of Garrison-Quincy-Ky-O-Heights Water District For A Rate Adjustment Pursuant to 807 KAR 5:076*, Case No. 2021-00094 (Ky. PSC Nov. 24, 2021); *Application of P.R. Wastewater Management Inc. For An Alternative Rate*, Case No. 2018-00339 (Ky. PSC Apr. 12, 2019); *Application of North Hopkins Water District For Rate Adjustment For Small Utilities Pursuant to 807 KAR 5:076*, Case No. 2018-00094 (Ky. PSC Aug. 16, 2018); *Application of West McCracken County Water District For An Alternative Rate Adjustment*, Case No. 2017-00319 (Ky. PSC Jan. 30, 2018); *Electronic Application of Letcher County Water District For Alternative Rate Adjustment*, Case No. 2017-00211 (Ky. PSC Nov. 21, 2017); *The Application of Hardin County Water District No. 1 For A General Rate Adjustment Effective On and After December 2, 2006*, Case No. 2006-00410 (Ky. PSC Aug. 2, 2007); *Adjustment of The Rates of Kentucky Turnpike Water District and The Imposition of An Impact Fee*, Case No. 98-398 (Ky. PSC June 30, 1999). In each of these cases, the PSC relied upon *Utilities Operating Co. v King*, 143 So.2d 854, 45 PUR3d 439, 443 (Fla. 1962) (“[I]n the absence of some showing that the service to the public will suffer by allowing the utility to charge rates which will not produce a fair return, the utility and not the Commission has the right of decision as to the rates it will charge so long as they do not exceed those which would produce a fair return as determined by the Commission.”).

<sup>5</sup> Staff Report at 3 and 8. \$1,346,034 (Pro Forma Total Operating Revenues) + \$211,617 (Revenues from 16.38 percent increase) = \$1,557,651.

<sup>6</sup> \$1,647,205 (Pro Forma Total Operating Expenses) - \$553,095 (Pro Forma Depreciation Expense) + \$209,984 (Average Annual Debt Service) = \$1,304,094.

<sup>7</sup> \$1,557,651 - \$1,304,094 = \$253,557.

<sup>8</sup> Staff Report at 21.

allow McCreary District to fully fund its depreciation reserve and will produce less revenue than the ratemaking methodology that the PSC has historically employed for water districts, it allows McCreary District to operate without any change in service quality.

If a 16.38 percent increase proves inadequate, processes exist to permit PSC intervention to adjust McCreary District's rates to protect McCreary District and its customers. In its application, McCreary District represented to the PSC that it would file an application for rate adjustment within 30 months of a final decision in the present proceeding.<sup>9</sup> Since the filing of McCreary District's application, the PSC has directed McCreary District to file another application for rate adjustment no later than 36 months after a final decision in this proceeding.<sup>10</sup> Accordingly, the PSC will have adequate opportunity to monitor McCreary District's financial condition and to take appropriate action should the requested increase of 16.38 percent be insufficient.

Employee Benefits. While the Commission Staff Report states that McCreary District's contributions for employee dental insurance were reduced 60 percent of the total employer contribution, its calculations in Appendix C show a reduction of only 40 percent of the employer contribution.

Depreciation. Commission Staff found that McCreary District's depreciation expense should be calculated using the mid-point of the average service life ranges found in the Commission on Rural Water's publication *O&M Guide for the Support of Rural Water-Wastewater Systems*. It made no recommendation as to whether McCreary District should henceforth calculate its depreciation expense for financial report purposes using that approach.

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<sup>9</sup> Application, Exhibit K at 2.

<sup>10</sup> *Electronic Application of McCreary County Water District For Approval To Issue Securities In the Approximate Principal Amount of \$3,450,000 For the Purpose of Refinancing Certain Outstanding Obligations of the District Pursuant To the Provisions of KRS 278.300 and 807 KAR 5:001*, Case No. 2022-00009 (Ky. PSC Mar. 16, 2022).

McCreary District requests that the PSC address that issue in its decision on the proposed rate adjustment.

Payroll Taxes. Commission Staff found that the members of McCreary District’s Board of Commissioners are not subject to federal payroll taxes and that their salaries should not be included in the calculation of McCreary District’s FICA taxes. Commission Staff reasoned that “[c]ommissioners are not employees of [the] district, but rather . . . are classified as independent contractors” and are not subject to payroll taxes.<sup>11</sup> It found instead that the members of the McCreary District Board of Commissioners are subject to federal self-employment taxes but provided no legal authority to support this finding.

Commission Staff’s finding conflicts with federal law. U.S. Treasury Department regulations provide that “[i]n order for an individual to have net earnings from self-employment, he must carry on a trade or business, either as an individual or as a member of a partnership.” 26 C.F.R. § 1.1402(c)-2(a) states that “the performance of the functions of a public office does not constitute a trade or business.”

A water district commissioner holds a public office. 26 C.F.R. § 1.1402(c)-2(b) defines “public office to include “any elective or appointive office of the United States or any possession thereof, of the District of Columbia, of a State or its political subdivisions, or a wholly-owned instrumentality of any one or more of the foregoing.”<sup>12</sup> Treasury Department regulations define employee to include public officers. 26 C.F.R. §31.3401(c)-1(a) states:

The term employee includes every individual performing services if the relationship between him and the person for whom he performs such services is the legal relationship of employer and employee. The term includes officers and employees, whether elected or

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<sup>11</sup> Staff Report at 20.

<sup>12</sup> See also *Commonwealth v. Howard*, 379 S.W.2d 475 (Ky. 1964) (holding that the office of water district commissioner is a public office).

appointed, of the United States, a State, Territory, Puerto Rico, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any one or more of the foregoing.

The Commission Staff finding also conflicts with the clear and unmistakable language of KRS 74.020(6). That statute provides that water district commissioners “shall receive a salary.” Independent contractors are not paid a salary, employees are. The payments to McCreary District’s commissioners are not paid on a fee basis. “A fee-based public official receives and retains remuneration directly from the public. An individual who receives payment for services from government funds in the form of wages or salary is not a fee-based public official, even if the compensation is called a fee.”<sup>13</sup> McCreary District’s commissioners receive their salary from McCreary District funds.

Accordingly, McCreary District respectfully requests that the PSC include in Payroll Taxes an amount sufficient to reflect McCreary District’s payment of federal payroll taxes on its commissioners’ salaries.

Nonrecurring Charges. McCreary District disagrees with Commission Staff recommendation that a return check fee of \$4.25 be established for sewer operations.<sup>14</sup> McCreary District customers receiving sewer service are also water service customers. Charges for water and sewer service appear on the same bill. Customers make a single payment for these services. McCreary District’s existing water service tariff provides for a return check fee. If a customer’s check for payment is not honored due to insufficient funds, the fee is assessed. Requiring a separate return check fee for sewer service is unnecessary. McCreary District agrees that when a bill for water and sewer service is involved, such fees should be equally allocated between its water and sewer operations and had revised its allocation rules to so provide.

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<sup>13</sup> *Federal-State Reference Guide*, IRS Publication 963 (July 2020) at 46 (available at <https://www.irs.gov/pub/irs-pdf/p963.pdf>),

<sup>14</sup> Staff Report at 7.

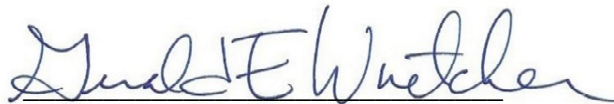
Cost Allocation Rules. In its Application, McCreary District has provided a set of rules for allocating common costs of its water and sewer operations. McCreary District requests that the PSC expressly address whether these rules are adequate and reasonable and should be followed for financial reporting purposes as well as ratemaking.

**Conclusion**

WHEREFORE, McCreary District requests that the PSC carefully consider the arguments presented in this Response and proceed in an expeditious manner to issue a decision on McCreary District's application. McCreary District waives its right to a hearing in this matter and to request a conference with Commission Staff.

Dated: April 4, 2022

Respectfully submitted,



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**CERTIFICATE OF SERVICE**

In accordance with 807 KAR 5:001, Section 8, and the PSC's Order of July 22, 2021 in Case No. 2020-00085, I certify that this document was transmitted to the PSC on April 4, 2022 and that there is currently no party that the PSC has excused from participation by electronic means in this proceeding.

