

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF ESTILL)
COUNTY WATER DISTRICT NO. 1 FOR AN) **CASE NO. 2023-00371**
ADJUSTMENT OF ITS WATER RATES)
PURSUANT TO 807 KAR 5:076)

RESPONSE TO COMMISSION STAFF REPORT

Pursuant to 807 KAR 5:076, Section 11(3), and the Public Service Commission’s (“Commission”) Orders of April 25, 2024 and May 24, 2024, Estill County Water District No. 1 (“Estill District” or “the District”) submits this response to the findings and recommendations contained in the Commission Staff report filed in this matter.

Estill District accepts Commission Staff’s recommended revenue requirement and rates and waives its right to a hearing in this matter and to confer with Commission Staff. This waiver of rights is conditioned upon Commission’s acceptance and adoption of Commission Staff’s recommended revenue requirement and rates. To permit an expeditious resolution of this matter, Estill District makes no formal objection to the findings and recommendations contained in the Commission Staff report. Its decision to refrain from formally objecting to a finding or recommendation does not represent agreement with that finding or recommendation. The District expressly reserves its right to contest the findings set forth in the Commission Staff report, other than recommended revenue requirement and rates, in future proceedings.

Estill District submits the following comments on the Commission Staff report:

1. Lack of Progress in Reducing Unaccounted-for Water Loss. In its report, Commission Staff noted that Estill District’s unaccounted-for water loss had not significantly changed since 2018. It failed, however, to report that the District experienced a significant

reduction in unaccounted-for water loss in calendar year 2023. Total unaccounted-for water loss fell from 39.90 percent in calendar year 2022 to 23.96 percent. This reduction reflects the completion of the Phase 11 Project improvements. In light of the Commission’s recent approval of the District’s use of surcharge funds to establish and equip a water leak detection team and to expand the District’s zone meter system, the District believes additional reductions in unaccounted-for water loss will be achieved in the current calendar year.

2. Failure of Motion for Authorization to Use Surcharge Proceeds to Refer to Prior Authorized Uses. In its report, Commission Staff erroneously notes that Estill District “was authorized to use surcharge proceeds to facilitate payment of debt service to the Kentucky Infrastructure Authority (KIA) in Case No. 2021-00064” but failed to reference this authorization in its Motion for Authorization to Expend Surcharge Proceeds.¹ To the contrary, the District in its motion expressly refers to that action and explains why it chose not to use the surcharge proceeds for that purpose:

In Case No. 2021-00207, Estill District sought and obtained Commission approval to use a portion of Surcharge proceeds to make principal and interest payments on KIA Loan 20-13. See Case No. 2021-00207, Order of July 2, 2021 at 3. As of this date, however, it has used only general revenue funds for interest payments on KIA Loan F20-013. Subsequent to the Commission authorizing the use of surcharge proceeds to service the principal and interest payments for KIA Loan 20-13, the District determined the use of surcharge proceeds for debt service was impractical and elected to forego their use for such purpose.²

3. Commission Staff’s Refusal to Include Labor Expense in Calculating the Cost of Nonrecurring Services. While Estill District accepts for purposes of this proceeding the

¹ Commission Staff Report at 8-9 (footnote omitted).

² Verified Motion for Authorization to Expend Surcharge Proceeds and to Continue Billing Surcharge Until December 31, 2025 at 8, fn. 23 (filed in *Electronic Application of Estill County Water District No. 1 for a Surcharge to Finance Water Loss Control Efforts*, Case No. 2019-00119 (Aug. 31, 2023)).

report's recommended revenue requirement and rates, it does not agree with the report's recommendation that labor costs related to the District's disconnection/reconnection fee, returned payment charge, and service call/investigation charge be excluded from the calculation of those charges. While it will not be directly affected by the removal of labor costs from those charges as those costs will be recovered through higher general service rates, the District respectfully submits that Commission Staff's recommendation is contrary to the Commission's regulations, will require general service customers to subsidize nonrecurring services through higher general service rates, and will send inappropriate pricing signals.

Commission Staff's recommendation is based³ upon the Commission's recently announced view that the wage and fringe benefits of the employees performing the activities related to nonrecurring charges are "fixed costs" that a water utility would incur regardless of the type of activity the employees perform. As these labor expenses are already incurred to provide general water service, the Commission has declared that "only the marginal costs related to the service should be recovered through a special nonrecurring charge for service."⁴ It has further declared that "allocating a fixed expense of ordinary labor costs in special nonrecurring charges like disconnect or reconnect fees creates a mismatch between how a utility incurs expenses and how it recovers those expenses from customers."⁵ Revising the methodology that it had used for at least the last four decades to calculate nonrecurring charges, the Commission announced that "only the

³ See Commission Staff Report at 6, fn. 18.

⁴ *Electronic Application of Hyden-Leslie County Water District for an Alternative Rate Adjustment*, Case No. 2020-00141 (Ky. PSC Nov. 6, 2020) at 20 ("It is unreasonable to allocate an expense already incurred as a cost of maintaining a system, such as the salary of a distribution operator, to a nonrecurring service such as the connection and reconnection of a meter during normal working hours."); *Electronic Application of Ohio County Water District for an Alternative Rate Adjustment*, Case No. 2020-00167 (Ky. PSC Dec. 3, 2020) at 4 (referring to labor costs as fixed expense); *Electronic Application of Southeast Daviess County Water District for an Alternative Rate Adjustment*, Case No. 2020-00141 (Ky. PSC Nov. 6, 2020) at 5 (referring to labor costs as fixed expense).

⁵ *Electronic Application of Ohio County Water District for an Alternative Rate Adjustment*, Case No. 2020-00167 (Ky. PSC Dec. 3, 2020) at 4.

marginal costs related to the service should be recovered through a special nonrecurring charge for service provided during normal working hours.”⁶ It has expressed the view that excluding such labor costs from nonrecurring charges and instead allocating them solely to general water service “more closely aligns those expenses with the actions that drive them.”⁷

Commission Staff’s recommended disconnection/reconnection fee, returned payment charge, and service call/investigation charge are contrary to the letter and spirit of 807 KAR 5:006. 807 KAR 5:006, Section 1(6) defines a “nonrecurring charge” as “a charge or fee assessed to a customer to recover *the specific cost of an activity*, which: (a) Is due to a specific request for a certain type of service activity for which, once the activity is completed, additional charges are not incurred; and (b) Is limited to only recover *the specific cost of the specific service*.” 807 KAR 5:006, Section 9(1) provides that a “utility may make special nonrecurring charges to recover *customer-specific costs incurred* that would otherwise result in monetary loss to the utility or *increased rates to other customers to whom no benefits accrue from the service provided or action taken*.”

When an Estill District employee performs a service call, makes a service reconnection, or processes a return payment, the employee performs labor for the District for which the employee is legally entitled to compensation at the agreed hourly wage rate. There is a specific monetary cost for the employee’s labor that the District incurs to provide the nonrecurring service.⁸

Estill District has provided the Commission with precise customer-specific costs, including the cost of labor, to support each of the nonrecurring charges in question. Commission Staff has

⁶ *Electronic Application of Southeast Daviess County Water District for an Alternative Rate Adjustment*, Case No. 2020-00141 (Ky. PSC Nov. 6, 2020) at 5

⁷ *Electronic Application of Hyden-Leslie County Water District for an Alternative Rate Adjustment*, Case No. 2020-00141 (Ky. PSC Nov. 6, 2020) at 19.

⁸); *Electronic Application of Southeast Daviess County Water District for an Alternative Rate Adjustment*, Case No. 2020-00141 (Ky. PSC Nov. 6, 2020) at 5.

not challenged the labor time required to provide the service or the wage rates used to calculate labor costs. In its report it makes no finding that the amount of any of the charges in question exceeded the actual cost that the District incurs to provide the service. Instead, Commission Staff ignores the occurrence of these costs and recommends denial of the District's recovery of the full cost of the nonrecurring activity through the nonrecurring charge and proposes *increased rates for general water service customers* who receive no benefit from the activity to compensate for this denial. Commission Staff acknowledges in its report that the rates for general water service customers must be increased to generate additional revenues of \$14,064 to recover the labor costs incurred solely for nonrecurring services.⁹

An administrative agency must follow the plain meaning of its regulations.¹⁰ The plain meaning of 807 KAR 5:006 does not support the interpretation that that “only marginal costs related to the service should be recovered through a special nonrecurring charge for service provided during normal working hours.”¹¹ 807 KAR 5:006, Section 9, expressly authorizes nonrecurring charges to recover *customer-specific costs*. It does not limit a utility's recovery to the marginal or incremental costs associated with an activity but rather defines a nonrecurring charge as a fee or charge “assessed to a customer to recover the *specific cost* of an activity.”¹² The recovery of all costs associated with the nonrecurring activity is consistent with water utility industry standard practice. The American Water Works Association's *Principles of Water Rates, Fees, and Charges* (7th ed. 2017), a source to which the Commission frequently refers, expressly

⁹ Commission Staff report at 11. If the current cost of labor is considered rather than the current nonrecurring charge, the total labor cost to provide nonrecurring services is \$17,616.

¹⁰ The District also incurs an opportunity cost to provide the nonrecurring service as the District employee performing that service could have been perform a task directly related to the provision of general water service that benefits all utility customers. Commission Staff gives no consideration of this cost.

¹¹ *Electronic Application of Hyden-Leslie County Water District for an Alternative Rate Adjustment*, Case No. 2020-00141 (Ky. PSC Nov. 6, 2020) at 19-20

¹² *Id.* at Section 1(6). See also 807 KAR 5:011, Section 1(4).

states that direct and indirect labor costs should be include in the calculation of nonrecurring charges.¹³ It notes that when developing nonrecurring charges “it is critical to accurately estimate *the true and full cost of labor* that goes into service delivery.”¹⁴

Commission Staff’s approach is nothing less than an improper and unlawful effort to modify 807 KAR 5:006, Section 9 (1) to limit the costs recoverable through the assessment of a nonrecurring charge to “marginal costs.” KRS 13A.130(1)(a) provides that “[a]n administrative body shall not by internal policy, memorandum, or other form of action . . . [m]odify a statute or administrative regulation.” KRS 13A.130(2) provides that “[a]ny administrative body memorandum, internal policy, or other form of action violative of . . . [KRS 13A130(1)] or the spirit thereof is null, void and unenforceable.” If the Commission wishes to limit the costs that may be included in a nonrecurring charge, it cannot do so by fiat through a staff report or by Order but must amend 807 KAR 5:006.

Commission Staff’s interpretation of 807 KAR 5:006, Section 9(1) produces arbitrary and unreasonable results. Consider two water utilities that are the same in all respects except for how they provide nonrecurring services. Utility A uses its own employees to perform nonrecurring activities such as customer reconnections. Utility B uses an independent contractor. The actual cost to perform the reconnections for each utility is \$70. The labor costs to perform the reconnection for each utility is \$50. Under Commission Staff’s interpretation, Utility B is permitted to recover the full cost of the reconnection (\$70) as the entire cost is not considered a fixed cost of general service.¹⁵ Utility A, however, is permitted to charge only \$20 as the labor

¹³ *Principles of Water Rates, Fees, and Charges* at 258-261.

¹⁴ *Id.* at 259 (italics and bolding added).

¹⁵ See, e.g., *Electronic Application of Duke Energy Kentucky, Inc. For: 1) An Adjustment of the Natural Gas Rates; 2) Approval of New Tariffs, and 3) All Other Required Approvals, Waivers, and Relief*, Case No. 2021-00190 (Ky. PSC Dec. 28, 2021) at 24.

costs incurred to provide the service are considered by the Commission to be “fixed costs” of providing general service. Despite performing the same service and incurring the same cost to perform that service, the utilities are treated in a disparate manner.

Finally, Commission Staff’s approach does not align the expenses for nonrecurring services with the actions that drive them, but instead provides false and misleading pricing signals to the District’s customers. Failing to include the full labor cost of the nonrecurring service in the charge suggests to District customers that the cost of the nonrecurring service is less than its actual cost and encourages greater use of that service than if the charge were set at the service’s actual cost. This greater use will require higher rates for general water service to compensate for the nonrecurring service’s unrecovered labor costs.

4. Commission Staff’s Recommended Disallowance of \$18,675 of the District’s Contribution to Employee Health Insurance. While Estill District accepts for purposes of this proceeding the report’s recommended revenue requirement and rates, it does not agree with the report’s recommendation that \$18,675 of the District’s test period expense be disallowed because the District’s contribution to the cost of its employees health insurance for employee coverage and employee and child coverage exceeded the national average employer contribution rate as determined by the U.S. Bureau of Labor Statistics (“BLS”). In making its recommendation, Commission Staff has not considered the following: the value of the total compensation package provided to the District employees; the individual elements of the health and dental insurance coverage provided to District employees; the labor market conditions; or the level of benefits, generally provided to employees in the utility sector or among Kentucky’s water utilities.

To reach its recommendation, Commission Staff relies heavily on the Commission-created presumption that employer contributions to employee health insurance plans that exceed the BLS

national average are unreasonable. It, however, ignores the Commission’s emphasis on “market competitiveness” that underlies the presumption. The Commission found that a utility “should limit its contributions to its employees’ health care plans to percentages that are marketplace competitive with other businesses.”¹⁶ The Commission suspected that, as utilities were monopolies lacking any competitors, they were not subject to market pressures to rein in labor costs, and were likely to incur excessive labor costs by assuming most or all of the cost of employee benefit packages. While finding that these benefit packages should be more closely review, the Commission did not limit the review to one specific benefit but stressed “evaluating employees’ total compensation packages, including both salary and benefits programs for market and geographic competitiveness to ensure the development of fair, just, and reasonable rates.”¹⁷

Commission Staff did not follow the Commission’s guidance. Its recommendation is based solely upon a mechanical application of the national average to the District’s health insurance cost. There is no evidence in the record to suggest that Commission Staff examined any factor that would assist in determining the reasonableness on the District’s expenditures for employee health insurance. It did not request any information regarding local labor market conditions, employee turnover, or the level of benefits commonly provided to employees in Estill County or the central Kentucky region. It has not questioned or evaluated **the total compensation package provided District employees**. The report is silent on how competitive the District’s total compensation package is with that offered by other central Kentucky employers or Kentucky water utilities. There is no finding that this compensation package is excessive vis-à-vis other Kentucky

¹⁶ *Application of Nolin Rural Electric Cooperative Corporation for a General Rate Increase*, Case No. 2016-00367, Order at 11 (Ky. PSC June 21, 2017). See also *Electronic Application of North Mercer Water District for Rate Adjustment Made Pursuant to 807 KAR 5:076*, Case No. 2016-00325, Order at 2-3 (Ky. PSC May 19, 2017).

¹⁷

employers who are competing for employees with similar work skills and experience. How can the District's package be considered excessive or overly generous if there is no comparison to the firms that the District must compete for employees? The District respectfully submits that comparisons with the practices of employers in Mississippi, or Arkansas or Montana or Utah or Maine are irrelevant. It is not competing with those employers, and it is unclear whether the conditions in those labor markets are the same as those Estill District faces. Considering such differences in locations and labor markets, the Commission Staff should explain how the national average is relevant to ascertaining the reasonableness of the District's total employee compensation package.

Asserting that KRS 278.190(3) imposes upon Estill District the burden of demonstrating the reasonableness of the expenditures does not justify Commission Staff's failure to address these issues. Estill District submitted its application pursuant to the Commission's Alternative Rate Adjustment Procedures.¹⁸ These procedures are intended to "establish a simplified and less expensive procedure for small utilities to use to apply to the [C]ommission for rate adjustments."¹⁹ Those procedures limit the evidence considered to the applicant's annual report, the application, information supplied by the parties in response to requests for information and the Commission Staff report.²⁰ The information that an applicant may provide in support of its application is restricted to that required by the application form (ARF Form-1) and Commission Staff's requests for information. By limiting an applicant's opportunity to submit evidence, the regulation shifts responsibility to Commission Staff to perform a thorough and complete review not only of the applicant's finances, but also the economic conditions under which it provides utility service. In

¹⁸ 807 KAR 5:076.

¹⁹ 807 KAR 5:076, Necessity, Conformity, and Function Statement.

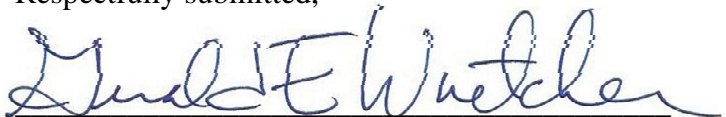
²⁰ 807 KAR 5:076, Section 3.

choosing to merely apply the BLS national average to the District's contribution to employee health insurance expense and not investigate the competitiveness of the District's total compensation package, Commission Staff did not meet its responsibility.

Finally, the evidence of the record does not support the assertion that the District failed to act reasonably to control its employee compensation costs. In the year following the test period, the District reduced its test period employee health insurance expense by \$30,751, or approximately 30.2 percent by shifting to health insurance coverage with a higher deductible and by eliminating its contribution for family coverage and providing only single employee or employee and child coverage. These efforts are evidence of reasonable efforts to control cost without adversely affecting employee morale, retention or recruitment. Commission Staff, however, gave these efforts little attention and did not consider them in its decision to recommend a disallowance of \$30,751 in medical expense.

Dated: June 4, 2024

Respectfully submitted,

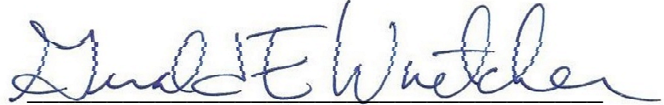


Gerald E. Wuetcher
Stoll Keenon Ogden PLLC
300 West Vine St. Suite 2100
Lexington, Kentucky 40507-1801
Telephone: (859) 231-3017
Fax: (859) 259-3517
gerald.wuetcher@skofirm.com

Counsel for Estill County Water District No. 1

CERTIFICATE OF SERVICE

In accordance with 807 KAR 5:001, Section 8, and the Public Service Commission's Order of July 22, 2021 in Case No. 2020-00085, I certify that this document was transmitted to the Public Service Commission on June 4, 2024 and that there are currently no parties that the Public Service Commission has excused from participation by electronic means in this proceeding.

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

Gerald E. Wuetcher