

COMMONWEALTH OF KENTUCKY
KENTUCKY PUBLIC SERVICE COMMISSION

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**PUBLIC SERVICE
COMMISSION**

In the Matter of:

TARIFF FILING OF KENTUCKY-AMERICAN)
WATER COMPANY TO REVISE THE) CASE NO.
KENTUCKY RIVER AUTHORITY) 2009-00124
WITHDRAWAL FEE)

**KENTUCKY-AMERICAN WATER COMPANY'S
MEMORANDUM IN SUPPORT OF THE
LINE-ITEM RECOVERY METHOD OF THE
KENTUCKY RIVER AUTHORITY WATER USE FEE**

In accordance with the Commission's August 18, 2009 Order in this matter, Kentucky-American Water Company ("KAW") submits this memorandum on the issue of the most appropriate method to be used to recover water use fees paid to the Kentucky River Authority ("KRA"). For numerous reasons, the Commission should continue to allow KAW and others under Commission jurisdiction to recover KRA water use fees via a line-item charge on customer bills.

KRS 151.720(5) empowers the KRA to collect "water use fees" from those who withdraw water from the Kentucky River and to "pass on all or any part of the fee." Thus, it is beyond question that KAW is specifically permitted by statute to pass on to its customers the *entire* amount of the KRA fees it pays. The Commission has raised the question of how best to pass on the fee. The line-item method of collecting from customers the fees that are paid is the fairest and most accurate way to "pass on" the fee to the end user of the water.

The Commission appears to be concerned that the holding in *Kentucky River Authority v. City of Danville*, 932 S.W.2d 374 (Ky. App. 1996) (holding that the KRA fee is not a tax)

somehow makes the line-item recovery method inappropriate. According to the Commission's August 18, 2009 Order in this matter, that concern stems from the idea that, in permitting KAW and other utilities to use the line-item recovery method, the Commission has somehow implied that the KRA fee is a tax. Specifically, in its Order, the Commission states that "the Commission has previously implied that the fee should be considered a license, franchise, or similar fee or tax."¹ The Commission appears to be concerned that, to the extent it has implied that the KRA fee is a tax, the holding in *KRA v. Danville* that it is not a tax is inconsistent with that implication. However, the holding that it is not a tax should have no bearing on how the KRA fee gets recovered.

KAW's Commission-approved tariff authorizes KAW to add "to the Customer's bill, as a separate item, an amount equal to the proportionate part of any license, occupation, franchise, fee or other similar fee, charge or tax now or hereafter imposed upon the Company . . . by the Kentucky River Authority . . . based on Kentucky River water usage"² Thus, the Commission has authorized KAW to use the line-item recovery method to collect taxes or fees KAW must pay for Kentucky River water usage. If the Commission had only authorized KAW to collect taxes it must pay for Kentucky River water usage, then the holding in *KRA v. Danville* that the KRA fee is not a tax would present a problem. But the Commission has already authorized and should continue to authorize recovery of fees or assessments paid for KAW's Kentucky River withdrawals. Certainly, if the Commission is concerned that use of the word "tax" in KAW's tariff sheet on this issue should be omitted to eliminate any perceived conflict between the tariff sheet and the holding in *KRA v. Danville*, KAW will revise its tariff sheet to address that concern.

¹ August 18, 2009 Order, p. 5.

² KAW's Tariff, Third Revised Sheet No. 55.

The KRA fee is not an expense like KAW's other expenses such as equipment costs, chemical costs, power costs, etc. Rather, the KRA fee is a statutory fee imposed at a rate KAW cannot control. To some extent, KAW can control most of its expenses. It can negotiate for the best available chemical prices, and it does. Likewise, it can exercise some control over its equipment costs by utilizing its bulk purchasing power to its advantage and seeking competitive bidding. Even fuel and power costs can be negotiated or reduced through changing equipment and operations at plants. Those types of expenses are properly included in KAW's rates to incentivize KAW to obtain the best prices possible so that its customers can enjoy low water rates. In other words, those expenses are subject to the ratemaking process and can only be recovered if they are incurred prudently.

On the contrary, KAW has no control over the "price" of the KRA fee. The law requires KAW to pay it. The law also allows KAW to "pass on" the entire amount of the KRA fee it pays. Inclusion of the KRA fee in rates rather than as a line-item charge could unfairly expose the fee to the ratemaking process. That process is appropriate and works for expenses over which KAW has some control. It would be unjust to subject the statutorily imposed fee to the same process.

The Commission, rate case intervenors and KAW customers closely scrutinize rate increases that KAW proposes. It is unfair to KAW and misleading to customers and the public to "add" onto those proposed rate increases fees that are not related to somewhat controllable costs. One of the main reasons KAW has always preferred the line-item recovery method of the KRA fee is that it makes clear to customers that a portion of their water bill goes directly to the KRA for support of infrastructure improvements at the Kentucky River. Inclusion of the KRA

fee into rates will deprive customers of that knowledge by converting a transparent method of recovering the fee into an opaque one.

The fact that the KRA fee is based on water withdrawals means that the amount of the fee can fluctuate widely from year to year depending on weather and other conditions. The existing method of line-item recovery based on estimated water withdrawals and water sales for the upcoming year with an annual true-up for any over/under collection is the fairest way to pass on the fee to customers. KAW's history demonstrates that it does not file rate cases annually. If the KRA fee were included in rates instead of a separate line-item charge that is trued up annually, the rates of the Company would either be too high or too low for an inordinate amount of time in between rate cases. In the absence of annual rate filings, fluctuations in the KRA fee would not be trued up as often. Then, when the true-up occurs, it would be less accurate due to customer additions and subtractions since the previous true-up. Of course, given the significant cost of a general rate case to KAW, the Commission and intervenors, practices that maximize the time between rate cases such as the line-item recovery method should be utilized.

Finally, the Commission's August 18, 2009 Order poses the question of whether the line-item recovery method that ensures total recovery of the KRA fee impedes KAW from minimizing its unaccounted-for water. In short, it does not. KAW's historic levels of unaccounted-for water have been lower than the 15% allowed per 807 KAR 5:066, Section 6(3). Additionally, in Case No. 2007-00134, KAW agreed to hire a consultant to assist in developing a program to cost-effectively manage non-revenue water. The consultant's report on that issue has been submitted to the Commission and offers good recommendations for cost-effectively reducing non-revenue water such as: cost-effective main replacement projects, minimizing third-party main breaks; improvement in the use of leak detection equipment; ensuring that meters are

appropriately sized; and installing meters upstream of leaking private mains so that owners of those mains will be responsible for the costs of those leaks. The implementation of the cost-effective recommendations³ should have a more meaningful and direct effect on the amount of non-revenue water than manipulation of the method by which the KRA fee is recovered.

Moreover, other incentives play a much bigger role in KAW's efforts to reduce unaccounted-for water. Water production costs for fuel, power, chemicals and waste disposal far outweigh the amount of the KRA fee, and KAW receives more revenue when it bills for all the water it supplies. Thus, any additional incentive derived by depriving KAW of its statutorily given right to pass on 100% of the KRA fees it pays would be *de minimus* and misplaced.

For the reasons set forth above, KAW respectfully requests the continued approval of the line-item recovery method of the KRA fee.

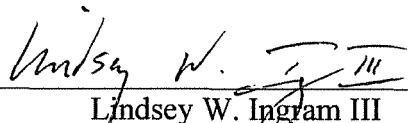
³ KAW will be filing a more detailed report on the implementation of recommendations on October 1, 2009 in Case No. 2007-00134.

Respectfully submitted,

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CERTIFICATE OF SERVICE

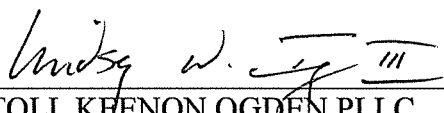
This is to certify that the original and ten copies of the foregoing has been filed at the Public Service Commission and a true and accurate copy has been served, via U.S. Mail, this the 30th day of September, 2009 upon the following:

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