

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

PROPOSED ADJUSTMENT OF THE WHOLESALE)
SERVICE RATES OF HOPKINSVILLE) CASE NO. 2009-00373
WATER ENVIRONMENT AUTHORITY)

ORDER

Hopkinsville Sewerage and Water Works Commission, doing business as Hopkinsville Water and Environment Authority (“HWEA”), proposes to increase its wholesale water service rates to Christian County Water District (“CCWD”) by 37 percent and to assess a monthly surcharge of \$4,261.58 for 36 months to recover its rate case expenses. By this Order, the Commission approves the proposed adjustment in HWEA’s wholesale rates and authorizes HWEA to assess a monthly surcharge of \$1,647.59 for 36 months.

BACKGROUND

HWEA,¹ a component unit of the city of Hopkinsville, Kentucky, owns and operates facilities that provide retail water and sewer services to the residents of Hopkinsville and the surrounding areas and provides wholesale water service to CCWD.

¹ HWEA is a five-member commission that supervises, manages and controls the business and affairs of the Hopkinsville sewerage and water works system, the Pembroke Utility Division and the Crofton Utility Division. Hopkinsville, Ky., Code of Ordinances §§ 51.035 and 51.041 (2010). Authority to revise HWEA’s rates resides in the Hopkinsville City Council. § 51.043.

CCWD, a water district created under KRS Chapter 74, provides retail water service to approximately 5,542 customers in Christian County, Kentucky.²

KRS 278.010(3) exempts municipal utilities from Commission regulation by excluding cities from the definition of utility.³ In *Simpson County Water District v. City of Franklin*, 872 S.W.2d 460 (Ky. 1994), however, the Kentucky Supreme Court held that this exemption did not extend to contracts for utility service between a municipal utility and a public utility. The Commission, therefore, has jurisdiction over HWEA's rates for wholesale water service to CCWD.

PROCEDURE

On September 3, 2009, HWEA provided written notice to the Commission and CCWD of its intent to increase its wholesale water service rates, effective October 5, 2009, by 37 percent to CCWD. CCWD filed written objections to the proposed adjustment with the Commission. On September 28, 2009, we established this proceeding, suspended HWEA's proposed rate adjustment until March 5, 2010,⁴ and directed HWEA to file certain information with the Commission within 21 days. We further granted CCWD leave to intervene in this proceeding.

² *Annual Report of Christian County Water District to the Public Service Commission for the Calendar Year Ended December 31, 2008* at 5 and 27.

³ See *McClellan v. Louisville Water Company*, 351 S.W.2d 197 (Ky. 1961).

⁴ On February 26, 2010, HWEA notified the Commission of its intent to place the proposed wholesale rates into effect for service rendered on and after March 5, 2010. By our Order of March 5, 2010, we permitted the proposed rates to become effective subject to refund and directed HWEA to maintain its records to determine the amount of any refund should a refund be ordered.

On October 19, 2009, HWEA moved for an extension of time to comply with the Commission's Order of September 28, 2009 and for an informal conference. In response to the motion, Commission Staff conducted an informal conference with the parties on October 29, 2009. Subsequently, the Commission extended the time for HWEA to submit the documents and information identified in the Order of September 28, 2009 until January 8, 2010. HWEA submitted these documents and information on January 8, 2010 and further advised the Commission that it had commissioned a cost-of-service study that it would file with the Commission upon completion. HWEA filed such study with the Commission on March 5, 2010.

On March 24, 2010, the Commission established a procedural schedule in this matter. In accordance with that schedule, HWEA filed the written testimony of four witnesses on March 29, 2010.⁵ Following submission of this written testimony, CCWD and Commission Staff conducted discovery upon HWEA. Although afforded the opportunity to present written testimony in this matter, CCWD did not submit written testimony. On May 21, 2010, CCWD and HWEA filed a written waiver of any right to an evidentiary hearing in this matter.

Based upon the parties' waiver, the Commission cancelled the scheduled evidentiary hearing but afforded the opportunity to HWEA to request recovery of rate case expenses and to provide evidence in support of such request. On May 28, 2010, HWEA requested recovery of \$153,416.81 of rate case expenses over a 36-month

⁵ These witnesses were: Len F. Hale, HWEA's General Manager; Derrick W. Watson, HWEA's Director of Operations; Russell King, HWEA's Director of Finance; and Brent A. Tippey, Vice President, HDR Engineering.

period. On June 2, 2010, CCWD filed a written objection to the proposed recovery of such expenses. This matter then stood submitted for decision.

DISCUSSION

This matter presents two issues: the reasonableness of the proposed adjustment in HWEA's wholesale rates and the reasonableness of HWEA's proposed surcharge to recover its rate case expenses.

Reasonableness of the Proposed Wholesale Rate

HWEA has provided two bases to assess the proposed rate adjustment. First, it argues that the agreement reached between the parties on December 8, 2005 to resolve Case No. 2005-00174⁶ permits an adjustment in HWEA's wholesale rates, provided that the same level of adjustment is made to HWEA's retail rates. HWEA notes that the Hopkinsville City Council recently adopted new rates for HWEA that are 37 percent higher than its previous retail rates.

Second, a recently conducted cost-of-service study indicates that HWEA's existing wholesale rates do not produce sufficient revenues to recover the cost of providing wholesale water service to CCWD. According to the report, during fiscal year 2009, HWEA incurred adjusted expenses of \$1,511,045 to provide wholesale water service to CCWD but received revenues of only \$792,577.⁷ To eliminate this deficit, wholesale rates should be increased by approximately 90 percent to generate additional revenues of \$713,320. In contrast, the proposed wholesale increase will increase

⁶ Case No. 2005-00174, *Hopkinsville Water Environment Authority* (Ky. PSC Feb. 9, 2006).

⁷ HDR Engineering Inc., *Cost of Service Study – Hopkinsville Water Environment Authority*, at 4-1(Lexington, Ky. Mar. 2010).

wholesale rates by only 37 percent and generate additional wholesale revenues of only \$293,253.

Our review of the evidence of record indicates that HWEA's proposed adjustment to its wholesale rates is reasonable and will not result in excessive rates. The results of the cost-of-service study demonstrate that the proposed wholesale rates will not generate revenues that exceed HWEA's reasonable expenses to provide wholesale service and a reasonable return on investment.⁸ We note that, aside from its initial objection to the proposed adjustment, CCWD has not disputed the reasonableness of the proposed adjustment or offered any evidence to contradict the cost-of-service study's findings.

Rate Case Expenses

A utility may properly recover reasonable rate case expenses as a cost of doing business.⁹ The Commission generally has permitted the recovery of rate case expenses in rates but has disallowed such expenses when a utility has failed to provide adequate documentary evidence of the incurrence of the expense,¹⁰ the expenses

⁸ To the extent that the proposed wholesale rates may not generate sufficient revenues to cover all expenses involved in the provision of wholesale service, the Commission is not required to establish a higher rate if no request for such rate is made. See *Utilities Operating Co. v. King*, 143 So.2d 854, 858 (Fla. 1962) ("if the rates requested by a utility are less than those which would provide a fair return the Commission must approve the rates unless it be shown that approval of such rates would cause the service rendered the public to suffer").

⁹ See *Driscoll v. Edison Light & Power Co.*, 307 U.S. 104, 120 (1939).

¹⁰ Case No. 2008-00250, *Frankfort Plant Board* at 7 (Ky. PSC Apr. 6, 2009).

related to a poorly or improperly prepared rate application,¹¹ and the utility failed to justify the high level of expenses for a relatively simple alternate rate filing.¹²

HWEA requests recovery of \$153,416.81 in rate case expenses over a 36-month period through a monthly surcharge of \$4,261.58. These expenses include the costs related to the preparation of the cost-of-service study (\$38,000), fees for special counsel (\$113,437.50), and special counsel's expenses for copying services, postage, and travel (\$1,979.31).

CCWD objects to the requested level of rate case expenses on three grounds. First, it argues that fees for legal research on the 2005 Settlement Agreement and its effect on the present proceeding are unrelated to the development and justification of the proposed rate adjustment and should be excluded from any rate recovery. Second, it argues that, as HWEA did not use the cost-of-service study to determine the proposed wholesale rates, expenses related to the study are unnecessary expenses and inappropriate for rate recovery. Third, it contends that, given the limited scope of this matter, the level of HWEA's rate case expenses is excessive for this case.

As to the first objection, we find no merit in CCWD's position that HWEA special counsel's review of the effect of the 2005 Settlement Agreement on subsequent Commission rate proceedings was unrelated to this rate proceeding. To the extent that provisions of the 2005 Settlement Agreement can be reasonably interpreted as establishing a methodology for the establishment of HWEA's wholesale rates and, thus,

¹¹ Case No. 8783, *Third Street Sanitation, Inc.* at 7 (Ky. PSC Nov. 14, 1983).

¹² Case No. 9127, *Sergent & Sturgeon Builders, Inc., Gardenside Subdivision Sewer Division* at 14 (Ky. PSC Mar. 25, 1985).

can potentially affect how the Commission would treat proposed rate adjustment, special counsel's review of HWEA was not unreasonable. The expenses associated with this review are not rendered unreasonable or precluded merely because HWEA initiated the review on its own and not in response to any CCWD argument. Clearly, an applicant's review and consideration of all potential issues is essential to preparing a rate application.

As to the second objection, CCWD argues that the expenses related to the cost-of-service study are not appropriately included in rate case expenses because HWEA did not use the study to establish the proposed rates. It notes that HWEA proposed a 37-percent rate increase prior to commissioning any cost-of-service study and failed to amend its proposed rates to reflect the study's results. The sole basis for this level of increase, CCWD further notes, is a similar level of increase in HWEA's retail rates. The study, it asserts, had no bearing or effect on HWEA's proposed rates.

The Commission is of the opinion that a cost-of-service study is a valuable tool to developing fair, just, and reasonable rates. It provides a thorough analysis of a utility's expenses and revenues and serves as a starting point for rate-making. Although HWEA's cost-of-service study was not undertaken until HWEA proposed its rate adjustment, it provides information that may be used to assess the reasonableness of the proposed rate adjustment. Clearly, from HWEA's prospective, the cost-of-service study is viewed as significant evidence that the proposed rates are not unreasonable or excessive.

The usefulness of any cost-of-service study is not limited to a particular customer class. Because the study identifies the costs and revenues derived from each class of

HWEA's customers, it is also a useful tool in reviewing existing retail rates and developing new rates that may better reflect the cost of service. Accordingly, the Commission finds that only a portion of the expenses of the cost-of-service study should be allocated to CCWD and that the remaining portion should be allocated to HWEA's retail customers. Using an allocation factor that is based upon each class's percentage of HWEA's total revenue requirement,¹³ we find that 19.3 percent of the expenses related to the cost-of-service study should be allocated to CCWD and that HWEA should be permitted to recover only \$7,334 of the costs related to the cost-of-service study through the temporary surcharge.

The Commission observes that HWEA's failure to prepare a cost-of-service study prior to submitting its proposed rate adjustment has likely resulted in increased litigation costs for all parties. If the cost-of-service study had been performed earlier and its results presented to the wholesale customer, we suspect that the parties would have more likely reached an agreement on the appropriate level to adjust the wholesale rate and avoided a significant portion of their litigation costs. Commission regulations, which currently require a public water utility with annual gross revenues greater than \$5,000,000 to file a cost-of-service study with its application for rate adjustment,¹⁴ afford potential parties an opportunity to assess an applicant's case for rate adjustment without intervening in the Commission proceeding.

¹³ See Case No. 2008-00250, *Frankfort Plant Board* at 13 (Ky. PSC Apr. 6, 2009).

¹⁴ 807 KAR 5:001, Section 10(6).

We find that the better practice in municipal rate adjustment proceedings is for the applicant to undertake and complete its cost-of-service study prior to filing notice of its proposed wholesale adjustment.¹⁵ Regardless of whether the municipal utility chooses to strictly adhere to the study's results, the study provides critical information regarding costs for the wholesale supplier and customer that, if widely known, is likely to result in agreement on prospective rate adjustments. We place HWEA and all municipal utilities on notice that, in future proceedings where a municipal utility has failed to conduct such studies prior to the filing of its proposed rate adjustment, the additional litigation costs incurred by all parties will be a factor that will be considered in assessing the reasonableness of the costs related to an "after-filing cost-of-service study."

As to CCWD's third objection, we agree that the level of rate case expenses appears excessive and unreasonable. Our review of Commission records indicates that, in previous municipal rate adjustment proceedings in which the Commission allowed recovery of rate case expenses, requested rate case expenses did not exceed \$68,000.¹⁶ As rate case proceedings vary in their levels of complexity and few municipal rate adjustment proceedings exist in which the Commission addressed the recovery of rate case expenses, we are reluctant to limit recovery of such expenses solely on past precedent. Nevertheless, the stark contrast between level of legal

¹⁵ We recognized that in some instances, especially those involving smaller municipal utilities, performing a cost-of-service study is not cost effective and will not result in any savings. Our discussion above is limited to larger municipal utilities that make a significant level of sales to wholesale customers.

¹⁶ Case No. 2008-00250, *Frankfort Plant Board* at 13 (Ky. PSC Apr. 6, 2009).

expenses incurred in those cases and those of the present case demands close examination of the special counsel's fees for which rate recovery is sought.

Kentucky courts generally consider the following factors when considering an award of attorneys' fees: (1) amount and character of services rendered; (2) labor, time, and trouble involved; (3) nature and importance of the litigation or business in which the services were rendered; (4) responsibility imposed; (5) amount of money or the value of property affected by the controversy, or involved in the employment; (6) skill and experience called for in the performance of the services; (7) the attorney's professional character and standing; and (8) results secured.¹⁷

Of great significance to the Commission are the amount and character of services that HWEA's special counsel rendered. Special counsel billed 412.5 hours of work. Of these hours, approximately 105 hours related to the cost-of-service study, including meeting with the consultant, reviewing draft versions of the cost-of-service study, verifying the accuracy of the study's exhibits, and filing the study with the Commission.

Having some familiarity with the preparation and contents of a cost-of-service study, we question the reasonableness of the number of billable hours that special counsel devoted to the study's preparation. HWEA commissioned the study from HDR Engineers. The author of the study, a professional engineer, had considerable experience in preparing cost-of-service studies. While it is reasonable for any attorney to become familiar with the final version of a cost-of-service report submitted to the

¹⁷ *Axton v. Vance*, 269 S.W. 534 (Ky. 1925); see also *Griffen Industries, Inc., Priester*, No. 2008-CA-002411, 2010 WL 1132963, at *4 (Ky. Ct. App. Mar. 26, 2010).

Commission, we find no reasonable basis for the special counsel's extensive involvement in the cost-of-service study's preparation, especially when the skills necessary for the study's preparation are primarily engineering and financial in nature. To the extent that HWEA required a point of contact to HDR Engineers to transmit documents and discuss issues related to its water system, it could have used an employee who was earning significantly less than \$275 per hour. To pay an hourly rate for an attorney's services for tasks that do not require the skills and experience of an attorney is not reasonable.

The record shows that HWEA's special counsel billed HWEA for approximately 190 hours to draft, compile, and review HWEA's responses to the Commission's Order of September 28, 2009. Based upon our review of our Order of September 28, 2009, which requested HWEA to furnish basic information regarding its operations, we fail to comprehend the significant level of time billed. While an attorney must review and prepare the final draft of any response to the Commission Order, assistants, accountants, paralegals, engineers, and other utility employees are able to gather and compile the requested information and then present it to an attorney in a form that will require minimal work on the attorney's part.

The high percentage of the special counsel's fees to total rate case expenses further suggests that the level of these fees is unreasonable. Special counsel fees represent approximately 74 percent of total requested rate case expense. In comparison, in more complex rate cases involving multiple parties and greater motion

practice, legal fees have represented less than 45 percent of rate case expenses.¹⁸ Such a large percentage suggests that HWEA failed to assign case responsibilities in a cost-effective manner and to properly supervise its special counsel.¹⁹

We find nothing out of the ordinary with this case to distinguish it from other rate case proceedings or to require the level of legal activity represented in the special counsel's billings. Our review of the record indicates limited procedural activity. No hearing or oral arguments were held. A single conference was held. HWEA did not prepare an application. The testimony of its witnesses consisted of 19 printed pages. No extraordinary motions or relief were sought. Discovery was very limited.

Finally, the level of rate case expenses is excessive when compared to the level of the requested rate adjustment. HWEA is requesting a 37-percent increase in wholesale rates, which would generate an additional \$293,253 in annual revenues. If the Commission were to allow HWEA to recover an additional \$113,437.50 for special

¹⁸ Kentucky-American Water Company has identified 38-45 percent of expenses for its past three rate cases to be attributed to legal fees. See Application Exhibit 37F, PSC Case No. 2010-00036, *Kentucky-American Water Co.*, at 11 (filed Feb. 26, 2010); Application Exhibit 37F, PSC Case No. 2007-00143, *Kentucky-American Water Co.*, at 12 (filed April 30, 2007). In Case No. 2008-00427, legal fees totaled \$194,844, or 45 percent, of Kentucky-American's \$432,995 claimed rate case expense. In Case No. 2007-00143, legal fees totaled \$179,115, or 38 percent, of Kentucky-American's \$466,742 claimed rate case expense. In Case No. 2004-00103, legal fees totaled \$441,694, or 41 percent, of Kentucky-American's \$1,081,715 claimed rate case expense.

¹⁹ Special counsel's sole invoice was issued on May 26, 2010, is identified as Invoice No. HWEA 2010-01, and includes all charges for services performed from August 1, 2009 through May 26, 2010. The lack of periodic invoices suggests that HWEA was not monitoring special counsel's services or the number of billable hours that was accruing.

counsel's fees over a three-year period, these fees would represent approximately 11 percent of the total rate increase.²⁰

Based on the discussion above, the Commission finds that the requested level of special counsel fees is unreasonable and the reasonable level of special counsel fees permitted to be recovered through a special monthly surcharge should not exceed \$50,000.²¹

SUMMARY

After reviewing the evidence of the record and being otherwise sufficiently advised, the Commission finds that:

1. HWEA's proposed wholesale rates represent a 37-percent increase in rates and will generate \$293,253 in additional annual revenue.
2. HWEA's proposed wholesale rates are fair, just, and reasonable and should be approved.
3. HWEA should be permitted to recover \$7,334 from CCWD for rate case expenses related to the cost-of-service study.
4. HWEA should be permitted to recover \$50,000 from CCWD for rate case expenses related to special counsel's fees.

²⁰ $\$113,437 \div 3 \text{ years} = \$37,812.$
 $\$37,812 + \$293,253 + \$7,334 + \$1,979 = \$340,378.$
 $\$37,812 \div \$340,378 = 0.11.$

²¹ We emphasize that our finding is narrowly tailored to the facts of this proceeding and we account for the unique circumstances of this case.

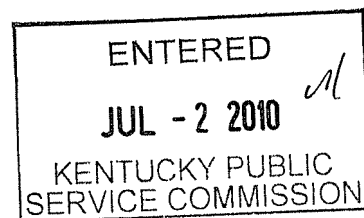
5. HWEA should be permitted to recover \$1,979.31 from CCWD for rate case expenses related to reimbursement of its special counsel's expenses for copying, postage, and travel.

6. HWEA should be authorized to assess a monthly surcharge in the amount of \$1,647.59 for the next 36 months to recover reasonable rate case expenses.

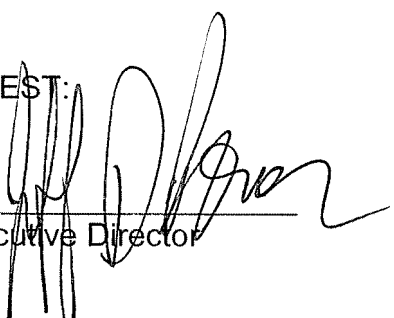
IT IS THEREFORE ORDERED that:

1. The rates listed in the Appendix to this Order are approved.
2. HWEA's request to assess a monthly surcharge of \$4,261.58 for 36 months is denied.
3. The rates set forth in the Appendix to this Order are approved for wholesale water service rendered by HWEA on and after March 5, 2010.
4. Within 20 days of the date of this Order, HWEA shall file revised tariff sheets reflecting the rates approved herein.

By the Commission



ATTEST:



Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2009-00373 DATED **JUL - 2 2010**

The following rates and charges are prescribed for the wholesale customers under the Commission's jurisdiction that are served by Hopkinsville Water Environment Authority. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

Wholesale Water Rate

First	3,000 cubic feet	\$ 2.96	per 100 cubic feet
Next	3,000 cubic feet	2.59	per 100 cubic feet
All Over	6,000 cubic feet	1.88	per 100 cubic feet

Monthly Rate Case Expense Surcharge (July 2010 through June 2013)

Christian County Water District	\$ 1,647.59 per month
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