

Commonwealth of Kentucky
Before the Public Service Commission

RECEIVED

APR 07 2006

PUBLIC SERVICE
COMMISSION

In the Matter of:

Application to Request Commission)
Approval for an Increase in Farmdale)
Development Corporation Sewage Treatment)
Plant's Rate Pursuant to the Alternative)
Rate Filing Procedure for Small Utilities.)

Case No. 2006-00028

Attorney General's Written Memorandum
In Response to the Public Service Commission's
Order of 20 March 2006

The Attorney General in response to the Commission's 20 March 2006 Order, submits this Written Memorandum. The response contains a section discussing the basis of the Attorney General's request. It also contains a section with specific responses for each of the issues set forth in Appendix A of the March 20th Order. The Attorney General expressly limits this memorandum to situations in which the Commission is processing an application for a rate adjustment under its alternative rate filing procedure.

I. THE BASIS OF THE ATTORNEY GENERAL'S REQUEST

On 19 January 2006, the Farmdale Development Corporation Sewerage Treatment Plant filed an application for a rate adjustment pursuant to the Alternative Rate Filing Procedure for Small Utilities. The Commission issued a "no deficiency" letter for the filing on 25 January 2006. The Attorney General thereafter, on 25 January 2006, sought intervention in the proceeding.

Generally, a utility seeking an adjustment in rates is subject to KRS 278.190 and the corresponding filing requirements set forth by regulation in 807 KAR 5:001. The general rate adjustment procedure requires a significant amount of information. Procedural due process safeguards are at all times applicable for such an application including the safeguard that the Commission's actions are based upon a public record. Therefore, the request for and submission of information for the development of an evidentiary record is through formal, on the record, discovery and public hearing process.

As a means to simplify the rate adjustment process for small utilities, the Commission, by regulation, provides a separate, alternative rate adjustment procedure set out by 807 KAR 5:076. The filing requirements for the alternative mechanism are substantially less than those for a general adjustment in rates, and this facilitates a less expensive procedure.

As a further means of facilitating a less expensive procedure, "an applicant may, in writing, request commission assistance in preparing the application." 807 KAR 5:076 § 3. On this point, the Commission may take

administrative notice that such requests are frequent, and Commission Staff has a well-established history of providing assistance.

Another feature that differs from a general rate adjustment application is that the administrative regulation calls for the applicant to submit one copy of the application to the Office of the Attorney General. 807 KAR 5:076 § 3. This requirement is an affirmative duty of the applicant in presenting the application that does not depend upon the Attorney General's intervention into the proceeding. Thus, providing the application to the Attorney General is yet another feature of the alternative method purposed to facilitate a least-cost (in terms of both time and money) review of the application.

A utility may recover the legitimate expenses it incurs in seeking an adjustment in rates. Consequently, the Attorney General, bearing in mind that the utility's customers are often called upon to fund rate case expense, uses this fact in making case-by-case assessments regarding his level of participation (e.g. the submission of requests for information, a request for a public hearing, etc.).

For applications under the alternative rate adjustment procedure for sewer utilities, intervention by the Office of the Attorney General is normal. Requests for information, however, are not as frequent, and requests for public hearings by the Attorney General are even rarer. It is usually the case that the Attorney General depends upon the application and the Commission Staff report as the basis for commenting, if necessary, on the request.

Reliance upon the Commission Staff report normally allows the Attorney General to avoid submitting duplicative information requests. Hence, the Attorney General considers the Commission Staff report the primary means by which the alternative rate adjustment procedure meets the goal of providing a simplified and less expense procedure. The importance of the written report to the alternative procedure cannot be overstated.

In this proceeding, the Attorney General has made the assessment that his level of participation for an 86.82% increase in "base" rates along with a \$27.92 monthly surcharge will be more active than simply waiting for the Staff Report. While it is true that the Attorney General could easily enough apply to the Commission for the establishment of a procedural schedule, submit requests for information, and seek a public hearing, that course of action may not be the most cost-effective (let alone simple) method for reviewing the financial activity of the applicant and the pending increases.

The Attorney General, who has previously participated in a field review by Commission Staff, has made the assessment that a request for participation in a field review is the proper regulatory "tool" or action for his review of this application. It is believed that participation has the potential to reduce or eliminate requests for information as well as the production of documents both of which help minimize costs, both in terms of dollars and time, and possibly eliminate the need for a public hearing. It is a pragmatic request, and it is not

wholly unlike the procedure by which a party may seek an informal conference with Commission Staff. 807 KAR 5:001 § 4 (4).

Pragmatism aside, it is also a request with a sound basis in procedural due process. By no later than the utility's filing of an application for an adjustment in rates, procedural due process safeguards are in place to govern the Commission's consideration of the application.

Section 2 of the Constitution of Kentucky provides due process protection against the exercise of arbitrary power. *Prichett v. Marshall*, 375 SW 2d 253 (Ky. 1963). The protection of Section 2 extends to administrative proceedings. *American Beauty Homes Corporation v. Louisville and Jefferson County Planning and Zoning Commission*, 279 SW 2d 450 (Ky. 1964).

Procedural due process includes the right of access to information. The Attorney General, as an intervenor, has a right to be heard on the means of proof by the applicant or any other party to the proceeding. *Mayfield Gas Company v. Public Service Commission*, 259 SW2d 8 (Ky. 1953). Due process includes the right to know what evidence is being considered. *Kentucky American Water Company v. Commonwealth ex rel. Cowan*, 847 SW2d 737, 741 (Ky. 1993); compare with, *Primm v. Isaac*, 127 SW 3d 630, 634 (Ky. 2004)(Rules of discovery are to be liberally construed so as to provide parties with relevant information fundamental to proper litigation.).

Thus, primary among the due process safeguards is the rule of fairness that a party has the right to be apprised of the evidence and arguments

considered by the Commission. For this reason, *ex parte* contacts are not favorites of the law. See *Louisville Gas and Electric Company v. Commonwealth of Kentucky, ex rel. Cowan*, 862 SW 2d 897 (Ky.App. 1993); compare KRS 13B.100. They can render void an agency decision.

For a general increase in rates, the evidentiary record is built through the filing requirement, discovery, and public hearings. The evidence enters into the record through specific channels and is otherwise publicly available to each party. For an alternative rate filing, the Commission expands the available channels to include evidence obtained via a field review.

If the Commission is going to use this channel, then it must recognize and promote the same due process safeguards that it applies to the other channels. Namely, under due process, it is a violation for the Commission to purposefully engage in *ex parte* communications with an applicant to the exclusion of other parties. The fact of the violation is manifest in the fact that the Attorney General is entitled to know what evidence is being considered and is entitled to test, explain, or refute that evidence. *Kentucky American Water Company v. Commonwealth ex rel. Cowan*, 847 S.W.2d 737, 741 (Ky. 1993)(citations omitted). Accordingly, if a violation occurs, due process affords the Attorney General a remedial measure for access to the information regarding the encounter through discovery and cross-examination of Commission Staff that participates in an *ex parte* field review. *Kentucky American Water Company*.

The question, from a procedural due process standpoint, is not whether Commission Staffs' encounter with the applicant may be examined. Rather, the question is how. Given that the goal of the alternative rate filing procedure is to provide "a simplified and less expensive procedure by which small utilities may apply" for a rate increase, participation in the field review offers a least-cost means (in terms of everyone's resources) of access to and examination of the evidence that the Commission reviews. Participation in a field review offers the opportunity to meet both the goal of a simplified process as well as the applicable due process requirements by avoiding *ex parte* contacts. One does not have to negate the other.

SPECIFIC RESPONSES FOR MARCH 20TH ORDER

1. Provide the constitutional or statutory provisions, if any, that permit the presence or participation of the AG or other parties at any field review that the Commission Staff conducts as part of a rate adjustment proceeding.

Response: There are no sections of the Constitution of Kentucky that expressly address Commission Staff field reviews; furthermore, there are no sections of the Kentucky Revised Statutes that expressly address the subject.

Upon the question of whether or not there are constitutional or statutory provisions addressing the necessity of the Attorney General or other parties to be able to participate in an exchange of information or other contact between the Commission and a party when the subject matter of the exchange is relevant to the merits of the proceeding formally before the Commission in its quasi-judicial capacity, the answer is found within the scope of procedural due process.

Procedural due process requires fairness in the proceedings. It is at all times applicable when the Commission is considering a matter in its adjudicatory capacity. *Ex parte* contacts are not favored. See *Louisville Gas and Electric Company v. Commonwealth of Kentucky, ex rel. Cowan*, 862 SW 2d 897 (Ky.App. 1993); compare KRS 13B.100. In fact, due process provides remedial measures as a means of addressing *ex parte* contacts. See *Kentucky American Water Company v. Commonwealth ex rel. Cowan*, 847 S.W.2d 737 (Ky. 1993). Thus, an *ex parte* contact that occurs in circumstances in which a non-participating party has made a request for participation clearly runs afoul of basic notions of fairness inherent in due process.

An applicant has no right to a field review. An applicant has no right to *ex parte* communications with the Commission. Accordingly, due process permits the presence or participation of the Attorney General or other parties because *ex parte* communications that occur during the purposeful exclusion of a party run afoul of principles of fairness.

The only qualification is that there may be other legitimate factors bearing upon the ability of the Attorney General or another party to participate in a field review (for example, lack of agreement regarding access to confidential information). However, these factors are matters independent from *ex parte* communication considerations. (For example, an applicant may not simply seek confidential treatment for all information as a pretext for limiting access.)


Participation in the field review would also further the purposed function of the alternative rate filing procedure to make the process more informal and less onerous for the applicant. Therefore, by observing the review including what was requested and asked as well as supplied and provided, the need to do this through a formal review process is alleviated. For areas not initially addressed by Staff meriting exploration or clarification, a simple question in the presence of Staff and the applicant could garner the answer without formal inquiry conducted in an otherwise unnecessary hearing of both Staff and the applicant. In this regard, participation in the field review mirrors the function of informal conferences held to aid the exchange of information in non-alternative rate filing applications.

2. Does due process require the presence of all parties at any field review that Commission Staff conducts as part of a rate adjustment proceeding if Commission Staff prepares and files in the record a written report of its findings and recommendations and submits to discovery and cross-examination by all parties at any hearing?

Response: The procedure described in the question is a remedial procedure. See *Kentucky American Water Company v. Commonwealth ex rel. Cowan*, 847 S.W.2d 737 (Ky. 1993). It is a due process cure in the wake of an *ex parte* contact. *Ex parte* contacts are not favored. See *Louisville Gas and Electric Company v. Commonwealth of Kentucky, ex rel. Cowan*, 862 SW 2d 897 (Ky.App. 1993); compare KRS 13B.100. To the extent that the question asks whether the Commission may deliberately engage in *ex parte* contacts with a utility to the exclusion of a party requesting participation and base the action on the availability of a remedy, that practice runs afoul of basic notions of fairness inherent in due process. See, for consideration, *Prichett v. Marshall*, 375 SW 2d 253 (Ky. 1963). The existence of a remedial measure can work to cure: but it does not work to authorize. To the extent that the question asks whether due process allows a party to waive "presence" at a field review, the answer is that presence may be waived.

3. How is any intervening party's ability to examine the evidence hindered if the party is provided a copy of any written report of Commission Staff's findings and recommendations, and if the party is permitted to conduct discovery of and cross examination of those Commission Staff members who prepared the written report?

Response: Presence at the actual encounter allows "first-hand" observation; therefore, it does not rely upon establishing what happened via the questioning of participants in an after-the-fact inquiry. Incomplete and inconsistent memories can prove a significant impediment as well as participants who become unavailable. Thus, one hindrance is that the intervening party must try to reconstruct and analyze the event through the participants. Further, in terms of due process, the procedure described is remedial measure. See *Kentucky American Water Company*. It is a hindrance to have to rely upon a remedial measure in lieu of being able to use a procedure or otherwise participate in a course of action that alleviates the need for remedial action.

- 
4. If the AG is permitted to be present at any field review that the Commission Staff conducts as part of a rate adjustment proceeding, does due process require the Commission to offer all other parties to the proceeding a similar opportunity?

Response: Yes.

5. KRS 278.230(1) permits the Commission and its employees to enter the premises of any jurisdictional utility for the purpose of examining its books or records, but that permission does not extend to all parties in a Commission proceeding. Provide the statutory or regulatory authority that allows the Commission to compel a utility to permit intervening parties to inspect utility records and interview utility personnel.

Response: The Attorney General agrees that KRS 278.230 (1) is a statutory provision that empowers the Commission with the right of access, during all reasonable hours, to the premises of any utility subject to its jurisdiction. The power is a continuing power of the Commission which does not activate or otherwise depend upon the filing of an application for an adjustment in rates (or the existence of any other Commission proceeding concerning the utility). To this extent, KRS 278.230 (1) does not direct any power to “intervening parties” because it does not rely upon the existence of a Commission adjudicatory proceeding as having any bearing upon its force. It is irrelevant.

When there is an application for an adjustment in rates pending before the Commission, the Commission has the power to review and investigate the application (KRS 278.190; KRS 278.310; also see, KRS 278.260). Commission authorization of requests for information to the applicant by intervening parties is a well-established practice by the Commission that is used in its review and investigation of such applications. Thus, when there is an application for a rate adjustment pending, the Commission may, upon request, compel a utility to provide access to the utility’s records. It is understood that the utility may object to such request and may also seek relief from such an order.

With regard to the Commission’s power for interviewing utility personnel, KRS 278.340 authorizes the Commission to “take depositions, or grant deposition rights at its discretion to any party in a proceeding before the commission.” Reading KRS 278.340 in tandem with the Commission’s powers under KRS 278.190, KRS 278.310, and KRS 278.260, the Commission may, upon request, compel the utility to allow an interview of utility personnel. Again, it is understood that the utility may object to such request and may also seek relief from such an order.

It remains paramount, however, that an applicant has no right to a field review and there is no right to *ex parte* communications. Whatever ability the Commission may have under KRS 278.230(1), it is not a device to suspend or extinguish due process rights for adjudicatory proceedings. It is irrelevant to this issue. If the Commission provides a procedure in the course of an adjudicatory proceeding, the procedure must comport with due process.

6. Must the utility applicant consent to the presence of other parties at any field review that Commission Staff conducts as part of a rate adjustment proceeding?

Response: First, the utility does not have a right to a field review, and it certainly has no right to an *ex parte* field review. Second, the applicant has no right to solicit an *ex parte* contact. The suggestion that the applicant has a right (through a requirement of consent) to deny the presence of other parties at a field review conducted by Commission Staff as part of a rate adjustment proceeding carries with it the notion that the applicant has a right to exclude other parties from its interactions with the Commission. Therefore, an applicant has no right to prevent a party from attending a field review. The only qualification is that there may be independent grounds for excluding a party from interactions with the Commission (e.g., the lack of a party entering into a confidentiality agreement as grounds to deny access to a portion of a hearing in which confidential information is being discussed, etc.), but even these grounds do not establish an absolute right to exclude exercisable in favor of the applicant.

7. In determining whether non-Commission Staff members, e.g., intervening parties, should be permitted to accompany Commission Staff on a Commission Staff field review, what weight, if any, should be given to the potential effect on the reviewers' ability to interview the utility employees, examine utility records and facilities, and otherwise conduct the review?

Response: There is no requirement that the Commission conduct *ex parte* filed reviews. In fact, there is no requirement that the Commission conduct any field reviews. A field review is an option that the Commission may pursue. If it does, it must comport with due process.

In terms of the decision as to whether to use this option and conduct a field review, the Commission may take the factors in the question into consideration. Given that the purpose of a field review for the alternative rate filing procedure is "to gather information concerning ... test year operating results and pro forma adjustments,"¹ it follows that furthering this purpose is the goal and achieving this goal will presumably be decisive in the decision as to whether to conduct such a review.

Again, however, the Commission does not have to conduct any field review. In an adjudicatory proceeding, there are due process requirements applicable to the Commission's interactions with the applicant that the Commission must observe. Hence, affording due process is of primary concern rather than conducting a review. (Otherwise stated, the due process inquiry is whether the Commission will conduct a field review in accordance with due process rather than whether the Commission will afford due process in the conduct of its field reviews.)

¹ *In the Matter of: The Application of East Laurel Water District for Approval of a Proposed Increase in Rates for Water Service*, Case No. 2005-00476, 22 March 2006 Staff Report on East Laurel Water District, page 1.

8. Does the AG expect to obtain any information by his presence at the Commission Staff field review that could not otherwise be obtained from review of Commission Staff's written report, discovery, and cross-examination of Commission Staff?

Response: Under the assumptions that the field review is thoroughly exhaustive, memories are complete and accurate, and all witnesses are available and with the qualification that this response does not discuss resource requirements, theoretically all information *could* be obtained from review of Commission Staff's written, discovery upon Commission Staff, and cross-examination of Commission Staff. The procedure described in the question, nonetheless, is a remedial measure for use in the wake of an *ex parte* contact. See *Kentucky American Water Company*. *Ex parte* contacts are not favorites of the law; therefore, actions necessitating the use of such a remedial measure should be avoided. The procedure is a remedy to remove harm and should not be construed as satisfactory substitute for the procedure that avoids the harm.

Further, to the extent that the question contains a notion that a party must demonstrate benefit in order for due process to apply, it is important to note that procedural due process is a safeguard that acts to prevent harm to the parties. It applies at all times during the course of an adjudicatory proceeding. A party may seek to exercise a right or obtain a remedial measure under due process, but a party need not take any action to activate due process protections. (For example, a public hearing is a procedural due process requirement. Whatever control that the Commission may exercise in the conduct of its hearings, it may not establish a rule under which a party's ability to be present at a public hearing held by the Commission is dependent upon the party demonstrating that a remedial procedure for a due process violation is not an adequate substitute for presence at the public hearing.)

Additionally, the information from participation in a field review that might be gained does not differ in nature from that that can be gained from the common practice of conducting informal conferences in which there is, generally, an expedited and less resource consumptive exchange of information among the applicant, Staff, and the other parties. Indeed, informal conferences with Commission Staff may be arranged through the Commission "at the request of any party." 807 KAR 5:001 Section 4 (4). It is no less appropriate or less common to encourage the informal exchange of information for small utilities than for large utilities, particularly when this promotes the goal of easing the administrative demands associated with an application for a rate increase.

WHEREFORE, the Attorney General submits his Written Memorandum in
Response to the Public Service Commission's Order of 20 March 2006.

Respectfully submitted,

GREGORY D. STUMBO
ATTORNEY GENERAL

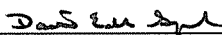


David Edward Spenard
Assistant Attorney General
1024 Capital Center Drive, Suite 200
Frankfort, KY 40601-8204
502 696-5457



Certificate of Service and Filing

Counsel certifies filing of the original and ten photocopies of the Attorney General's Written Memorandum in Response to the Public Service Commission's Order of 20 March 2006 by hand delivery to Beth O'Donnell, Executive Director, Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601; furthermore, service of the filing was by mailing a true and correct of the same, first class postage prepaid, to Carroll F. Cogan, Farmdale Development Corporation, 1706 Bardstown Road, Louisville, Kentucky 40205, Kenny & Marilynn Glass, 223 Briarwood Drive, Frankfort, Kentucky 40601-8141, Marry Pennington, 210 Cherry Lane, Frankfort, Kentucky 40601 and Beverly J. Hunt, 304 Peachtree Road, Frankfort, Kentucky 40601-8141, all on this 7th day of April 2006.


Assistant Attorney General