

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

APPLICATION OF MOUNTAIN WATER)
DISTRICT FOR AN ADJUSTMENT OF) CASE NO. 2014-00342
WATER AND SEWER RATES)

ATTORNEY GENERAL'S POST-HEARING BRIEF

Respectfully submitted,

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ATTORNEY GENERAL'S POST-HEARING BRIEF

Comes now the intervenor, the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention, and tenders the following post-hearing brief in the above-styled matter.

I. STATEMENT OF THE CASE

Mountain Water District (“the District”) filed an application to increase water and sewer rates with the Public Service Commission of Kentucky (“the Commission”) on November 20, 2014.¹ The District filed the last general rate case in 1997, but additional increases were also awarded for sewer in 2006, and water in 2008.² These increases were subject to Rural Development loan agreements administered under KRS 278.023.³

Mountain Water District is a non-profit water district, administered by a five member board of commissioners,⁴ and serves approximately 17,300 retail water customers and 2,400 sewer customers in Pike County. It sells water at wholesale to four non-affiliated water distribution systems: Elkhorn City, Jenkins, Mingo County Public Service District, and Martin County Water District.⁵ The District also operates two sewage treatment plants, eight package sewage plants and has two wholesale agreements for sewage treatment.⁶ Additionally, the District purchases water from the City of Pikeville, Kentucky and the City of Williamson, West Virginia.⁷

¹ *Application of Mountain Water District for an Adjustment of Water and Sewer Rates*, Case No. 2014-00342 (Ky. PSC November 20, 2014) (hereinafter “Application”) at paragraph 5.

² *Id.* at paragraph 5.

³ *Id.*

⁴ *Id.* at paragraph 2.

⁵ *Id.* at paragraph 4.

⁶ *Id.*

⁷ Direct Testimony of Sawyers, p. 2, Response 6.

The District has proposed a revenue increase of \$2,046,979 per year for water, from \$8,081,343 to \$10,128,321.⁸ This constitutes a 25.33 percent increase in water rates based upon the District's proposed Rate Alternate 1 and is an across the board rate increase not based upon the cost of service study.⁹ The District has also proposed a revenue increase of \$1,573,322.25 for sewer, from \$989,822.80 to \$2,563,145.05.¹⁰ This constitutes a 159 percent rate increase also based on a proposal to use Rate Alternate 1 rather than the cost of service study.¹¹ Mountain Water District's application relies upon a twelve (12) month historical test period ending June 30, 2014,¹² and, per the District, includes adjustments for known and measurable changes.¹³

The Attorney General, by and through his Office of Rate Intervention sought and was granted full intervention by Order of the Commission on January 9, 2015, and is the only intervenor of record.¹⁴ The Commission conducted a public hearing for the purpose of cross-examination of witnesses on this matter on May 20, 2015.¹⁵

II. ARGUMENT

The Mountain Water District, the utility, has failed to meet its burden of proof to show "that the rates contained in its application were just and reasonable"¹⁶ as required by KRS 278.190(3).¹⁷ Therefore, the Attorney General opposes the substantial increase in revenue that Mountain Water District is requesting and asks the Commission to deny the application in a

⁸ Application, Exhibit B-3, Schedule W-G, p. 1 of 1.

⁹ *Id.*

¹⁰ *Id.*, Exhibit B-6, Schedule S-E, p. 2 of 2.

¹¹ *Id.*, Exhibit B-6, Schedule S-D, p. 1 of 1.

¹² Application, Exhibit B, Appendix A, Schedule App-A-4

¹³ *Id.* at paragraph 7(a).

¹⁴ Case No. 2014-00342, Order (January 9, 2015)

¹⁵ Case No. 2014-00342, Order (March 12, 2015)

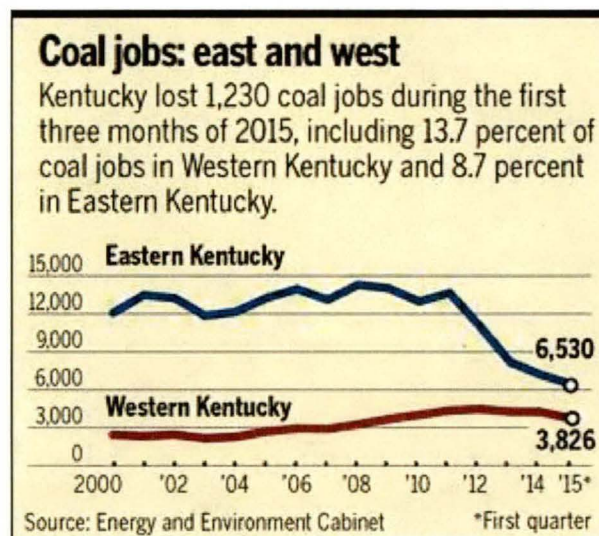
¹⁶ *Kentucky-American Water Company v. Commonwealth ex rel. Cowan, Ky.*, 847 S.W.2d 737, (1993); KRS 278.190(3).

¹⁷ *See* KRS 278.190, "At any hearing involving the rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the utility..."; *See also Energy Regulatory Commission v. Kentucky Power Co.*, 605 S.W.2d 46, 50 (Ky. App. 1980). (At such hearing and through the Commission proceeding, the municipal utility seeking the rate adjustment bears the burden of showing that the proposed adjustment is reasonable.); *See* KRS 278.030(1).

manner consistent with the positions outlined in his Brief. If the District’s application is accepted as is, it would result in unjust, unfair, and unreasonable rates due to the following issues.

A. IMPACT ON THE RATEPAYERS

The residents of Pike County have faced a steep and severe economic decline that mirrors the decline of coal production in Appalachia, and to compound the last two decades of struggle, more than 1 in 10 coal jobs were lost during the first three months of 2015, see table below.¹⁸



While all of Kentucky faces a continued and sustained reduction in coal production in both Eastern and Western Kentucky counties, the “drop in coal jobs has caused a particular hardship in Eastern Kentucky because coal had long been a dominant piece of the economy.”¹⁹ Average annual employment in the state’s eastern coalfield dropped from 14,412 in 2008 to 7,287 in 2014.²⁰ The loss of good paying coal jobs reduces the per capita income, and increases the

¹⁸ “Report: Kentucky lost more than 1 in 10 coals jobs during first three months of 2015,” Bill Estep, Lexington Herald-Leader, April 30, 2015. www.kentucky.com/2015/04/30/3828148_report-kentucky-lost-more-than.html?rh=1#storylink=cpy

¹⁹ *Id.*

²⁰ *Id.*

underemployed and unemployed population in Pike County. According to the United States Census Bureau data, 23.4 percent of Pike County residents live below the poverty line, and the per capita income is a dismal \$19,351.²¹

Based upon the severe economic situation that currently exists in Pike County, the Attorney General finds it problematic that Mountain Water District proposes to place a 25.33 percent water rate increase²² and 159 percent sewer rate increase²³ on the shoulders of those who can least afford it. The level of increase the District is seeking creates concern for the Attorney General as it is inconsistent with traditional concepts.

Under the rates proposed by the District, the average residential water bill of \$32.05 will jump to an estimated \$40.17 per month.²⁴ As for the District's stated average metered sewer bill, a customer who receives both water and sewer with the District currently pays \$24.20, but will pay \$62.67 per month under the proposed rate increase.²⁵ The sewer rates are even higher for the flat rate customers, who will see their bills go from \$29.00 to \$75.10 per month. Finally, those customers with aerator systems will see their bills rise from \$33.45 to \$86.62 per month.

Under the District's proposed rates, a customer with only an "average" consumption will be paying well over \$100 per month for water and sewer service. Moreover, this bill amount is only for those customers with average usage, so many customers will pay more than \$100 per month. The customers that maintain only sewer service through the District will be paying just shy of \$100 per month, for just one basic service. These rates for water and sewer would be deemed unfair, unjust, and unreasonable throughout the state of Kentucky, and will be even more difficult for customers who are living in a poverty stricken region of the Commonwealth.

²¹ AG's Hearing Exhibit 1 (May 20, 2015).

²² Application, Exhibit B-3, Schedule W-G, p. 1 of 1.

²³ Application, Exhibit B-6, schedule S-D, p. 1 of 1.

²⁴ Application, Exhibit B-3, Schedule W-M, p. 1 of 3, Table 1 Comparison of Future Bills to Existing Bills.

²⁵ Application, Exhibit B-6, Schedule S-J, p. 1 of 1, Table 1 Comparison of Future Bills to Existing Bills.

Public Comments received by the Commission at the Public Meeting held on April 16, 2015 in Pikeville echo the concerns about the most vulnerable citizens of Pike County. The Magistrates of the Pike County Fiscal Court are very concerned about the people they represent, and as Magistrate Hilman Dotson testified at the hearing, their greatest concern are those who can least afford the increase, “the old and elderly and on fixed income, you know we as leaders are responsible for taking care of our people.”²⁶ The Attorney General shares the concerns expressed by the public comments tendered, and argues that a resident who subsists on the per capita income of \$19,351 or less, can ill afford to pay over \$100 per month for water and sewer service.

For the reasons stated herein, the District’s proposed rate increase would lead to unfair, unjust, and unreasonable rates. The 25 percent water rate increase and 159 percent sewer rate increase should be denied because the citizens of Pike County will not have the ability to pay those rates as requested.

B. THE DISTRICT’S PROPOSED RATE DESIGN FOR WATER SERVICE IS UNREASONABLE.

Mountain Water District’s proposed rate design to increase water rates for all customer classifications by 25 percent is unreasonable and not supported by the evidence in the record. Mountain Water District hired Kevin Howard, P.E. to perform a Cost of Service Allocation Study to determine the appropriate revenue requirement and customer rates for both water and sewer.²⁷ According to the District, the “purpose of the study was to allocate the total cost of service, which is the total revenue requirement, to the several customer classifications.”²⁸ The cost of service includes operation and maintenance expenses, depreciation and amortization

²⁶Public Meeting, Hilman Dotson, VTE 13:22- 13:35.

²⁷ Direct Testimony of Howard, p. 2, Response 4.

²⁸ *Id.* at Response 6.

expense, taxes other than income, and debt service costs. In the study, the total costs were allocated to the Residential, Commercial, Multi-Family, Industrial, Public Authority, and Wholesale classifications.²⁹

Even though the District contends that the cost of service study was commissioned to properly allocate the cost of service among the customer classifications, the District's proposed Rate Alternate 1 is not based upon the cost of service study.³⁰ Under the proposed rate design advocated by Mountain Water District, both the Residential and the Multi-Family customer classifications would pay **more** than the cost of service study allocation.³¹ The Residential customers and Multi-Family customers would pay \$33,874 and \$196,000 more than the actual cost to serve these classes, respectively.³²

Under the District's proposed rates the Commercial, Industrial, Public Authority, and Wholesale customer classes would all pay **less** than the cost to serve each of the specified classes.³³ If the proposed rates, which are not based upon the cost of service study, are implemented, the following unjust results will occur: (1) the Commercial class will pay \$76,665 less than the actual cost to serve the class; (2) the Industrial class will pay \$10,660 less than the actual cost to serve the class; (3) the Public Authority will pay \$11,862 less than the actual cost to serve the class; and (4) the Wholesale class will pay \$130,889 less than the actual costs to serve the class.³⁴ While the Residential and Multi-Family customer classes would overpay, the Commercial, Industrial, Public Authority, and Wholesale customer classes would pay less than the actual costs to serve those respective classes; in other words, will not be paying their fair

²⁹ *Id.*

³⁰ VTE 17:38:04 – 17:38:10.

³¹ Application, Schedule W-A, p. 1 of 1, Summary of Pro Forma Revenues Under Present and Proposed Rates for the Test Year July 1, 2013 through June 30, 2014. (emphasis added.)

³² *Id.*

³³ *Id.* (emphasis added.)

³⁴ *Id.*

share.³⁵ The Residential and Multi-Family customers would be unfairly subsidizing the rates of the other classes.³⁶

Analyzing the Wholesale customer class revenue requirement under the District's proposed rates, the District will only recover \$224,234.³⁷ According to the cost of service study this amount is not enough to cover the Wholesale customer class' responsible portion of operation and maintenance expenses of \$262,264.³⁸ If under the proposed rates the Wholesale customer class is not even covering the costs to operate and maintain that class within the District, then it certainly is not paying for any of the additional expenses associated with serving the Wholesale customers such as depreciation, taxes, and debt service.³⁹ Based upon this information, it appears that both the Residential and Multi-Family customers are subsidizing Mountain Water District sales to its wholesale clients,⁴⁰ including Mingo County Public Service District in West Virginia, and other counties of the Commonwealth.⁴¹

In addition to the issues discussed with the proposed rate design, the Attorney General also takes exception with the fact that an arbitrary and estimated 3 percent electricity rate increase was incorporated,⁴² into the cost of service study.⁴³ For these reasons, Mountain Water District's proposed rate design is not fair, just, or reasonable, and should not be utilized in the setting of rates. Because the proposal forces Residential and Multi-Family customer classifications to subsidize the rates of Commercial, Industrial, Public Authority, and Wholesale

³⁵ *Id.*

³⁶ VTE 17:42:23.

³⁷ *Id.*

³⁸ Application, Exhibit B-2, Schedule W-C, p. 3 of 15, Cost of Service for Pro Forma Year July 1, 2013 through June 30, 2014 Allocated to Customer Classifications.

³⁹ Application, Exhibit B-2, Schedule W-C, pp. 1-15.

⁴⁰ Mountain Water District's Response to AG 2-13.

⁴¹ *Id.*

⁴² Mountain Water District's Response to AG 1-49, AG 2-41, AG 2-42, and AG 2-43.

⁴³ Direct Testimony of Howard, Response 12, and *In re the Application of Kentucky Power Company for (1) A General Adjustment of its Rates; (2) Approval of its 2014 Environmental Compliance Plan; (3) Approval of Tariffs and Riders ; and (4) An Order Granting all Other Required Approvals and Relief*, Application, 14 November 2014, (Ky. PSC 2014-00396).

customer classifications, and fails to address deficiencies in the financials, the Attorney General contends that the rate proposal should be rejected.⁴⁴

C. MOUNTAIN WATER DISTRICT'S COST TO RUN INDEPENDENTLY REPRESENTS A SIGNIFICANT COST SAVINGS AND BENEFIT TO THE RATEPAYERS.

The PSC required Mountain Water District to submit a financial summary of the cost to return to in house operations, and to state specifically the cost of on-going independent operation of the District.⁴⁵ PSC Staff directed Mr. Michael Spears, the contract CPA for the District, to submit a side-by-side cost comparison for in-house operations and the UMG current contract costs.⁴⁶ Mr. Spears' submission suggested that the District would see an initial annual savings of at least \$374,565 if operations were brought back in-house.⁴⁷ This sum is understated based on flaws that may be identified in Mr. Spears' analysis. The Attorney General takes issue with two basic assumptions of Mr. Spears' comparison, that: (1) the staffing levels would remain the same and (2) the repair and maintenance budget is reasonable and supported by documented evidence.

Mr. Spears testified that he made no adjustments to current contractor staffing levels, nor did he perform any objective analysis to discern if any positions could be consolidated or eliminated. Rather his analysis simply carried over 100 percent of the contractor's employees, which included: two executive assistants, two customer service managers, an Operations Manager, a Senior Project Manager, an Electrical Maintenance Manager, an HR Director, a

⁴⁴ VTE 17:42:23.

⁴⁵ Mountain Water District Responses to PSC IC Data Request No. 3.

⁴⁶ Mountain Water District Responses to PSC IC Data Request No. 3; VTE 13:38:38- 13:38:40.

⁴⁷ Mountain Water District Responses to PSC IC Data Request No. 3.

Safety Officer, and seven separate Area Managers, among a multitude of hourly employees which were deemed to be necessary to run the day to day operations.⁴⁸

The only salary study that was provided in this rate case was a survey by the Kentucky Rural Water Association (KRWA) which provided salary ranges for particular positions common to rural water districts.⁴⁹ The KRWA salary survey was only compared to the contractor's salary levels, and not to possible consolidated positions.⁵⁰ Asked to locate upper level management positions and executive assistants on the KRWA Salary Study,⁵¹ a survey submitted by over 125 rural water utilities in Kentucky, Mr. Spears was unable to do so.⁵² The comparison of the contractor positions to the KRWA salary survey showed that a majority of the contractor positions were at or above the maximum salary range, demonstrating that UMG's salaries are on average higher than the other Rural Water Districts in the Commonwealth.⁵³

The second assumption that Mr. Spears premised his analysis upon was a \$758,439 annual budget for repair and maintenance ("R&M").⁵⁴ The annual budget for R&M has increased every year since the inception of the contract with UMG.⁵⁵ The increases are so substantial that at the start of the new contract extension of March 27, 2014, the sum of \$118,932 was forgiven in R&M overages by UMG, as both parties were aware that the District did not have sufficient income to continue to pay the contract fee, the R&M fee, and still have sufficient funds left over to make the required bond payments.⁵⁶ The exact amount of the R&M total

⁴⁸ Mountain Water District Response to PSC Clarification Data 6(b)(2), VTE 13:39:41-13:39:45.

⁴⁹ Mountain Water District Response to PSC Clarification Data 6(b)(1).

⁵⁰ Mountain Water District Response to PSC Clarification Data 6(b)(1).

⁵¹ Mountain Water District Response to PSC Clarification Data 6(b)(1).

⁵² Mountain Water District Response to PSC Clarification Data 6(b)(2), VTE 13:43:52-13:45:35.

⁵³ Mountain Water District Response to PSC Clarification Data 6(b)(3).

⁵⁴ Mountain Water District Responses to PSC IC Date Request No. 4.

⁵⁵ Mountain Water District Response to AG 2-98, Exhibit 98 and Mountain Water District Response to AG 1-48(b).

⁵⁶ Mountain Water District Responses to AG Clarification No. 8, AG 2-28 and AG 2-73,

overage, or under budget, or forgiven funds is unclear.⁵⁷ But what is clear is that UMG pays some expenses out of pocket, and Mountain Water pays some directly, and therefore the District cannot illuminate a clear path for how these vendor payments get paid, billed or logged.⁵⁸

Mountain Water District's employees claim to have oversight of every repair invoice billed and paid out under R&M expenses.⁵⁹ However, throughout the Discovery process Mountain Water District was unable to point to even one example of a UMG work order expense that was rejected or denied.⁶⁰ As Vice-Chair Gardner pointed out, UMG has an "incentive" to keep the budgeted R&M low, because the contract guarantees payment for the overages regardless of how much the total exceeds the budget.⁶¹

The District's Response to Post Hearing Data Requests for the amounts actually paid by Mountain Water related to R&M overage for the last five years, and the amounts that were forgiven in the last five years,⁶² lacks any detail or analysis. It also appears that the summary provided post hearing specifically contradicts the terms of the March 27, 2014 Contract, where it states that \$118,932 of the R&M overage was forgiven upon execution.⁶³ These discrepancies and uncertainties underscore concern that there is a lack of financial oversight in the billings submitted to the District for payment. There is no incentive for UMG to keep the R&M costs low, as any amount that exceeds the set fee is repaid through R&M overage account.⁶⁴ This expense should not be carried over in Mr. Spears's analysis for in-house operational costs, as the

⁵⁷ VTE 14:57:00 – 14:58:45.

⁵⁸ Mountain Water District Response to AG 2-45, Response to PSC 2-21(e); VTE 11:58:00-11:58:40; VTE 13:25:00 – 13:27:20.

⁵⁹ Mountain Water District Response to AG Clarification Nos. 9-10, and VTE 11:50:50, AG 2-77.

⁶⁰ Mountain Water District Response to AG Clarification Nos. 9-10.

⁶¹ Mountain Water District's Response to Post Hearing Data Request No. 14.

⁶² Mountain Water District's Responses Post-Hearing Data Request No. 14.

⁶³ Mountain Water District's Responses Post-Hearing Data Request No. 14.

⁶⁴ Mountain Water District Response to AG Clarification Data No. 8.

sum is not fully supported by credible evidence of what the R&M budget would be if the District returned the operations back in-house.

Additionally, Mr. Spears' analysis does not reflect elimination of the Corporate Fee or the Corporate Overhead.⁶⁵ The comparison balance sheets do not reflect a decrease of \$767,927 for the Corporate Fee (\$300,000) and the Corporate Overhead (\$467,927).⁶⁶ Those additional savings would inure to the rate payers, should the District return to independent operations.

The comparison financial analysis is not a comprehensive analysis. The District grossly understated the costs to run the District independently, and failed to consider the savings that would inure to ratepayers if UMG profits were eliminated.

D. MOUNTAIN WATER DISTRICT'S AVERAGE WATER LOSS OF OVER 30 PERCENT VIOLATES 807 KAR 5:066 SECTION 6(3) AND IS THEREFORE UNREASONABLE.

Mountain Water District has requested a deviation from 807 KAR 5:066 Section 6(3) to address its historical problem of substantial unaccounted-for line loss. The deviation proposed by the District would reduce the current level, 30.2 percent, over the next five years to 25 percent, and to 20 percent total unaccounted for line loss by 2025.⁶⁷ The current application seeks a deviation from Commission regulation, but the District has not submitted any credible evidence sufficient to meet the burden of proof to establish an alternative level and the request should be denied.

The governing regulation from which the District is requesting a deviation states specifically:

[F]or rate making purposes a utility's unaccounted-for water loss shall not exceed fifteen (15) percent of total water produced and

⁶⁵ Mountain Water District Responses to PSC IC Data Request No. 3.

⁶⁶ Mountain Water District Response to PSC Clarification No. 4(a) and No. 4(b).

⁶⁷ Mountain Water District's Response to PSC Clarification Data No. 15(b).

purchased, excluding water used by a utility in its own operations. Upon application by a utility in a rate case filing or by separate filing, or upon motion by the commission, an alternative level of reasonable unaccounted-for water loss may be established by the commission. A utility proposing an alternative level shall have the burden of demonstrating that the alternative level is more reasonable than the level proscribed in this section.⁶⁸

The District documents 30.2 percent unaccounted-for water loss in the test year.⁶⁹ A Water Loss Control Program was implemented in 2005, which purports to set up a systematic review to address system losses.⁷⁰ Notwithstanding the plan on file, there has been no documented improvement or reduction in the substantial water loss since its inception.⁷¹ This proposal to reduce line loss to 20 percent was not supported by any specific activity contained within the District's Water Loss Plan, nor was there any mention of conducting an audit, working on the metering systems, nor did the plan contain "any hard evidence to support this goal."⁷² The burden is on the District to show that the alternative they present is reasonable, and they have failed to do so.⁷³

In the past, the Commission has required that utilities with high unaccounted-for water loss must offer plans that identify the sources of loss, the amount of each from each source, establish priorities and a time table for addressing each source, all of which should be supported by a detailed financing plan for addressing these priorities.⁷⁴ Additionally, the problems with line loss are not novel issues for the District, and historically there has been no documented improvement since UMG took over operations.

⁶⁸ 807 KAR 5:066 Section 6 (3).

⁶⁹ Mountain Water District's Response to PSC Clarification Data No. 15(b).

⁷⁰ Mountain Water District's Response to PSC Clarification Data Request, No. 15, Exhibit to No. 15.

⁷¹ VTE 15:56:40-15:57:07.

⁷² Mountain Water District's Response to AG 1-60.

⁷³ 807 KAR 5:066 Section 6 (3).

⁷⁴ See generally, *In re: Green Hills Water District*, October 7, 2003 Order, (Ky. PSC 2002-00420) and *In Re: Cannonsburg Water District's Unaccounted-For Water Loss Reduction Plan, Surcharge and Monitoring*, August 7, 2014, Order (Ky. PSC 2014-00267).

The District has reported a substantial unaccounted-for line loss that far exceeds the 15 percent statutory limit since the mid 1990's.⁷⁵ The unaccounted-for water loss so substantial during Mountain Water District's Management Audit of 1997 that the Commission ordered a surcharge for an additional \$277,225 in revenues, to be collected over a three year period to create and implement a plan to reduce the excessive line loss the District was documenting.⁷⁶

Currently, the only plan suggested by either UMG or the District, is to upgrade the aging infrastructure and completely replace the lines.⁷⁷ The District maintains that until it obtains funding for capital projects, line loss will remain stagnant.

Yet, not even one application is pending for funding a capital project other than this rate case. Even though no new applications have been submitted since 2014, the District has a balance of \$4,740,932.89 in donated capital from Coal Severance projects that are currently being billed.⁷⁸ Whatever the future brings for new Coal Severance Projects, all but \$286,220.87 is earmarked for sewer projects, and is over four times the current annual budget for sewer.⁷⁹ While there is a distinction between daily maintenance and repairs and construction to replace infrastructure, the \$4.5 million in donated capital (grants actually received) for sewer-specific projects could be utilized to offset the requested 159 percent rate increase.

In addition to the donated capital that is currently awaiting use for infrastructure investment, the contractor needs to be directing more of its payments towards the same goal of replacing aging lines and meters. The Division of Water has suggested, via a letter submitted to Grondall Potter, an agent of the private contractor, that a water district's goal for reinvestment

⁷⁵ *In Re An Investigation into the Operations and Management of Mountain Water District*, 30 May 1997, Order and Staff Recommendation (Ky. PSC 1996-00126).

⁷⁶ *Id.*

⁷⁷ VTE at 15:54:53-15:55:50.

⁷⁸ Mountain Water District Response to Post-Hearing Data Request 8, Exhibit 8.

⁷⁹ *Id.*

into infrastructure should be approximately 100 percent of the depreciation rate.⁸⁰ Yet, Mountain Water District is currently reinvesting its existing operating revenues at a rate of 5.97 percent to support its aging system.⁸¹ While the donated capital level for reinvestment into infrastructure are more in line with DOW recommended levels, the contract rate was of concern for DOW. However, since the letter was sent in 2013, no action was ever taken on the DOW recommendation, and the District never sought a contract amendment.⁸²

Even if the District's alleged plan to address line loss was to invest more money into the capital expenditures to replace the aging infrastructure, no funding source was identified to assist in achieving the stated goal of 10 percent reduction. As the District has not met its burden, no deviation should be allowed, and any costs above the 15 percent should be disallowed, including costs for power and chemicals allotted to the production of the unaccounted-for non-revenue water. As much as UMG Project Manager Mr. Grondall Potter would like the Commission to believe that UMG bears the costs of the lost water,⁸³ the financial witness for UMG, Mr. Bob Meyers clarified and explained that "every penny that Mountain Water District pays us comes from the ratepayers."⁸⁴

As recommended by the Division of Water, the funds paid to UMG by Mountain Water District should have a minimum level of reinvestment into infrastructure that exceeds the current 5 percent level, and the contract should be amended to address that deficiency. The reinvestment levels should be increased by 10 percent every year, until such time as the money spent for reinvestment capital is equal to 100 percent of depreciation funds.

There is no evidence to support the requested deviation of 807 KAR 5:066 Section 6(3)

⁸⁰ Hearing Exhibit AG-4.

⁸¹ *Id.*

⁸² VTE 15:27:18.

⁸³ VTE 16:00:10-16:00:26.

⁸⁴ VTE 16:38:25-16:38:

and the request should be denied. All revenues expended to support unaccounted-for line loss that exceeds 15 percent, and as was recommended in 1997 Staff Report of the District's Management Audit, the costs directly related to lost water production including but not limited, to electricity and chemicals, should also be disallowed.⁸⁵

The Commission should require that the District prepare and submit a comprehensive Water Loss Plan, which includes details of sufficient specificity for funds to support the plan, within six months of the entry of an Order in this underlying action. Further reporting and monitoring requirements of the PSC can then be implemented once the District has filed a comprehensive water loss plan, to ensure that the substantial unaccounted-for line loss can be brought within the regulatory limits.

E. THE COMMISSION SHOULD ASSESS THE VALUE THE CONTRACT WITH UMG BRINGS TO RATEPAYERS.

Mountain Water District entered into a private contract with the Utility Management Group ("UMG") on July 3, 2005, for operations, maintenance, and management services for both water and sewer facilities.⁸⁶ The District renewed the contract with UMG in 2008, 2011, and 2014.⁸⁷ The most recent contract renewal was executed between the District and UMG on March 27, 2014,⁸⁸ with a December 31, 2016 expiration date.⁸⁹ According to the most recent contract between the District and UMG, the District must provide notice of termination of the contract in writing no less than one hundred and eighty (180) days in advance of the effective date of termination, and notice cannot be given prior to January 1, 2016.⁹⁰

⁸⁵ *In Re An Investigation into the Operations and Management of Mountain Water District*, 30 May 1997, Order and Staff Recommendation (Ky. PSC 1996-00126) and Mountain Water District Response to Post-Hearing Data Request 21.

⁸⁶ Direct Testimony of Sawyers, p. 2, Response 6.

⁸⁷ Mountain Water District's Response to AG 1-50. *See also*: Mountain Water District's Response to AG 2-2.

⁸⁸ Application, Exhibit O, p. 1.

⁸⁹ *Id.* at p. 14.

⁹⁰ *Id.*

Under the terms of the contract the day to day operations of the District's water and sewer divisions are carried out by UMG staff including the following: operation and maintenance, customer service, meter reading, leak detection, purchased water, electricity, billing, and administrative and supportive functions for the District staff.⁹¹ Mountain Water District maintains two employees. Roy Sawyers is the District Administrator and Carrie Hatfield is the Finance Administrator,⁹² who report directly to the Board of Commissioners of the District.⁹³ District Administrator Sawyers states that his job responsibilities are, "to monitor UMG's day to day operation of the District's facilities and to make sure that the systems are operated in a safe, efficient manner and in compliance with applicable regulations."⁹⁴ As the District Administrator, Mr. Sawyers asserts that he also supervises the Financial Administrator Carrie Hatfield, whose job duties include processing UMG invoices, preparing financial statements, and generally assisting him on a day to day basis.⁹⁵

Mr. Sawyers contends that "the payments to UMG have reached a level that the District cannot meet without additional revenue" (or in other words, a rate increase) because of the contract with UMG requiring increases in payments, and to fund certain costs in excess of the contracted amount.⁹⁶ The Commission should assess whether Mountain Water District should receive the requested rate increase given that the UMG contract may not be a prudent expenditure of ratepayer funds.

⁹¹ Direct Testimony of Sawyers, p. 3, Response 9.

⁹² Mountain Water District's Response to AG 1-52.

⁹³ Direct Testimony of Sawyers, p. 2, Response 6.

⁹⁴ *Id.* at p. 4, Response 11. *See also*, Mountain Water District's Response to AG 1-51.

⁹⁵ Mountain Water District's Response to AG 1-51; Mountain Water District's Response to AG 2-45(b).

⁹⁶ Direct Testimony of Sawyers, p. 3, Response 8.

F. MOUNTAIN WATER DISTRICT'S FAILURE TO ENGAGE IN COMPETITIVE BIDDING SINCE 2005 OF A MULTI-MILLION DOLLAR YEARLY CONTRACT IS NOT REASONABLE.

Mountain Water District's failure to engage in an arms-length, independent bidding process for a multi-year, multi-million dollar request for qualifications and price proposals for operations, maintenance, and management services contract cannot be ignored.⁹⁷ During the initial bidding process, Mountain Water District did not use the total price of the contract proposed by the bidders as a determining factor when awarding the contract, nor did it place any weight on the experience of the bidders.⁹⁸ The District did not display reasonable or prudent rationale when awarding a contract of this magnitude and not taking the price or experience of the bidders into consideration.

Despite the fact that the contract with UMG for both operational expenses as well as repair and maintenance ("R&M") expenses continued to escalate year after year, with only a few exceptions,⁹⁹ Mountain Water District failed to conduct a competitive bidding process.¹⁰⁰ The original contract price in 2005, extrapolated out to a calendar year, was \$6,250,750 for Operations and \$416,082.20 for R&M.¹⁰¹ Comparing the 2005 UMG contract price to the 2014 operational expense of \$7,111,200 and the actual R&M amount paid of \$704,353.22, it is clear that the costs associated with this contract have risen sharply. The District has failed to provide information about the amounts of the R&M overage budget actually paid by the District, and the amounts that were waived or forgiven by UMG.¹⁰² It is clear, however, that the amount paid

⁹⁷ See e.g. Mountain Water District's Response to AG 1-22(a) and Exhibit 22(a)(i).

⁹⁸ *Id.*, Exhibit 22(a)(i), Memo from Management Advisory Committee to Mountain Water Board of Commissioners.

⁹⁹ Mountain Water District's Response to AG 1-48(b). See: Mountain Water District's Response to AG 2-98, Exhibit 98.

¹⁰⁰ Mountain Water District's Response to AG 2-21(a) and AG 2-30(a).

¹⁰¹ Mountain Water District's Response to AG 1-48(b). See: Mountain Water District's Response to AG 2-98, Exhibit 98.

¹⁰² Mountain Water District's Response to Post Hearing Request for Information No. 14.

continues to get larger each year.¹⁰³ The most recent contract entitles UMG to yet another increased fee for 2015 and 2016.¹⁰⁴ Nevertheless, the District irresponsibly continued to renew the multi-million dollar water and sewer contracts with UMG, even in the face of the continuous price increases each and every year, knowing that the District could not afford these increases.¹⁰⁵

Furthermore, the District admits that it did, “not know exactly how much it would cost to operate the District...”¹⁰⁶ Accordingly, the District did not know whether the UMG contract price was a benefit or detriment to the ratepayers. Throughout the underlying proceeding, the Commission requested that the District perform the proper analysis to estimate how much it would cost if Mountain Water District ran independently, without a third-party contractor.¹⁰⁷ The cost comparison demonstrated that if the District ran independently, then it would achieve at least a savings of \$375,000.¹⁰⁸

Mountain Water District attempts to justify its failure to engage in competitive bidding for its operation, maintenance, and management contract since 2005 by stating that if the contract had been cancelled with UMG at any point, then the District would have been forced to pay off “various loans” that UMG had made to the District.¹⁰⁹ Mountain Water District describes the loans that UMG provided as “self-forgiving loans that were ‘amortized’ over a period of time.”¹¹⁰

In fact, Mountain Water District included an amortized portion of a \$500,000 loan, amortized over 5 (five) years with a 5(five) percent interest rate,¹¹¹ that UMG had given to the

¹⁰³ Mountain Water District’s Response to Post Hearing Request for Information No. 14.

¹⁰⁴ Application, Exhibit B, Appendix C, Mountain Water District and UMG 2014 Contract.

¹⁰⁵ Direct Testimony of Sawyers, p. 3, Response 8. *See*: Mountain Water District’s Response to AG 2-2.

¹⁰⁶ Mountain Water District’s Response to AG 2-3(b).

¹⁰⁷ Mountain Water District’s Response to PSC Clarification Request for Information No. 18.

¹⁰⁸ *Id.*

¹⁰⁹ Mountain Water District’s Response to AG 2-2(a). *See*: Mountain Water District’s Response to AG 2-21(a).

¹¹⁰ Mountain Water District’s Response to AG 2-2(a).

¹¹¹ Mountain Water District’s Response to AG 2-84.

District, in the long term debt liabilities section of its application.¹¹² It is unclear based upon the information provided in this case, whether or not the District has attempted to include the amortized amount for any of the “self-forgiving loans” to be calculated into the rates. If these “self-forgiving loans” are in fact in the debt service to be included in the rates, then the Attorney General requests that the Commission disallow these amounts since the District never expended any monies on these specific loans.

Additionally, Mountain Water District did not act prudently when the contractor continuously refused to provide verified audited financials for the District’s review.¹¹³ The District continued to renew the contract instead of engaging in competitive bidding or amending the contract language to build in safeguards and protections to the contract during the renewal negotiations.¹¹⁴ The lack of protections afforded to Mountain Water District and its ratepayers in the contract with UMG are a significant issue the PSC must consider when evaluating this case.

G. THE COMMISSION SHOULD EVALUATE REASONABLENESS OF THE CORPORATE FEE AND ALLOCATION OF EXPENSES

UMG charges Mountain Water District a myriad of overhead costs incurred by the private contractor during the daily operations of servicing all of its clients, including the District, and allocates those expenses to its various clients based upon the revenue received per client contract.¹¹⁵ Based upon the information provided by UMG, the District is allocated almost 64% of all the shared/overhead costs incurred by UMG, based upon total revenues received from the client contracts.¹¹⁶ According to UMG these allocation percentages will vary since it is based

¹¹² Application, Exhibit K, Mountain Water Balance Sheet Schedule of Liabilities.

¹¹³ Mountain Water District’s Response to AG 1-50.

¹¹⁴ *Id.*; See: Mountain Water District’s Response to AG 2-2(a).

¹¹⁵ Mountain Water District’s Response to AG Clarification Request for Information No. 5. Mountain Water District’s Response to PSC Clarification Request for Information No. 1; VTE 16:40:40 – 16:41:00.

¹¹⁶ Mountain Water District’s Response to PSC Clarification Request No. 4; VTE 16:40:57 – 16:41:08.

upon the amount of revenue that UMG receives via client contracts.¹¹⁷ When it comes to the two UMG owned businesses, Air Management Group (“AMG”), a heating and cooling system installations and maintenance business,¹¹⁸ and Small Engine Solutions (“SES”), a mechanics’ business that repairs, services, and sells equipment, UMG changes its allocation policy.¹¹⁹ Instead of using total revenue dollars as the basis to allocate costs, UMG uses the “estimated average time” that UMG personnel purportedly spends on AMG and SES business.¹²⁰ UMG admits that this is an estimated percentage, not based on a formal time study, and the private contractor provided no evidence to support the estimations.¹²¹ As a result, UMG only allocates a mere 5% of the shared/overhead costs to both AMG and SES.¹²²

Thus, the allocation of expenses by UMG is arguably inefficient because UMG utilizes two very different allocation methodologies – one for its clients, including Mountain Water District, and a different one for its two businesses AMG and SES. Either UMG should allocate and assign expenses based upon revenues received by the specific entity, or based upon a formal time study. In fact, the witness Meyer admitted at the public hearing that if UMG used the same allocation methodology across the board, then it would be easier to ascertain whether Mountain Water District ratepayers were paying a reasonable share, and not overpaying for the UMG corporate overhead.¹²³

¹¹⁷ Mountain Water District’s Responses to AG Clarification Request No. 5. *See*: Mountain Water District’s Responses to PSC Clarification Request No. 4.

¹¹⁸ VTE 16:41:38 – 16:41:44.

¹¹⁹ Mountain Water District Response to AG Clarification Request for Information No. 5; Mountain Water District Response to PSC Clarification Request for Information No. 7; VTE 16:41:23 – 16:41:51.

¹²⁰ Mountain District Response to AG Clarification Request for Information No. 5; Mountain Water District Response to PSC Clarification Request for Information No. 7.; VTE 16:41:25 – 16:43:47; VTE 16:44:57 – 16:45:24.

¹²¹ *Id.*

¹²² VTE 16:42:05 – 16:42:15.

¹²³ VTE 16:45:28 -16:46:45.

UMG declined to provide the revenues for AMG and SES.¹²⁴ Without this information it is virtually impossible to assess whether the allocation of expenses for the District are fair, just, or reasonable since UMG is applying two very distinct allocation methodologies. The Commission should determine in light of these two methods of overhead cost allocation, which is more fair and reasonable to the rate payer.

Two of the most significant UMG corporate expenses that are allocated to the Mountain Water District each year based on this flawed methodology are the corporate overhead expenses (\$467,927)¹²⁵ and a Corporate Fee (\$300,000).¹²⁶ According to UMG, Corporate Overhead expenses include personnel costs for employees who work on other UMG client projects in addition to Mountain Water District projects.¹²⁷ Other costs allegedly included in the Corporate Overhead expense are lease expenses for the central office, utilities, general liability and property insurance premiums, professional fees, vehicle expenses, travel expenses, and supplies.¹²⁸ As discussed previously, since the allocation methodology that UMG employs is not reasonable, the \$467,927 for allocated corporate overhead expenses should be reviewed to determine what is fair. The Commission should similarly evaluate whether the \$300,000 Corporate Fee is reasonable for ratepayers to pay.

H. MOUNTAIN WATER DISTRICT'S CONTINUOUS AND SYSTEMATIC SALARY INCREASES ARE UNREASONABLE.

Presuming the deteriorating financial condition that Mountain Water District asserts, the District should have taken multiple steps to improve its financial profile, yet it neglected to do

¹²⁴ VTE 16:46:35 – 16:47:47.

¹²⁵ Mountain Water District's Response to AG Clarification Request for Information No. 7; Mountain Water District's Response to PSC Clarification Request for Information Nos. 1, 4, and 7. VTE 16:40:15 – 16:40:37.

¹²⁶ Mountain Water District's Response to AG Clarification Request for Information No. 7; Mountain Water District's Response to PSC Clarification Request for Information Nos. 1, 4, and 7. VTE 16:38:40 - VTE 16:39:12.

¹²⁷ Mountain Water District's Response to AG 2-46(a). *See*: Mountain Water District's Response to PSC Clarification Data Request No. 1(a) and (b).

¹²⁸ *Id.*

so. Therefore, the District should not be rewarded for its own poor oversight. Chiefly, Mountain Water District admits that in the midst of one of the most severe economic declines to affect Eastern Kentucky, and which led to the persistent loss of thousands of good paying coal associated jobs,¹²⁹ it provided regular wage increases for its salaried employees.¹³⁰ In addition to the District's continuous and systematic raises provided to its employees, it also continued to approve and renew a contract with UMG that provided its employees an average of 3% wage increases per year,¹³¹ with many UMG employees receiving a much higher raise per year.¹³²

Mountain Water District has been granting salary increases to its employees each and every year from their hire date through 2014.¹³³ It is not reasonable for the District to grant to its employees continuous salary increases in the face of the severe job loss and declining economy in Eastern Kentucky.

Mountain Water District's typical customer has an extremely low per capita income, according to the United States Census Bureau data.¹³⁴ The District's ratepayers in Pike County only make an average of \$19,351 per capita each year, and well over 23 percent of the entire county falls below the poverty line.¹³⁵ In fact, Mountain Water District's employee's salaries are on average three times more than the per capita income of its ratepayers.¹³⁶

Mountain Water District has not limited salary increases in order to improve its financial condition, and instead has filed a rate increase request for over \$3.6 million dollars. The District

¹²⁹ Mountain Water District's Response to AG 2-29; Mountain Water District's Response to AG 1-40; VTE 10:31:27 – 10:31:39.

¹³⁰ Mountain Water District's Response to AG 1-55.

¹³¹ Mountain Water District's Response to AG 2-21(d).

¹³² Mountain Water District's Response to AG Clarification Request for Information No. 4, Exhibit 4; Mountain Water District's Response to PSC Clarification Request for Information No. 6, Exhibit 6(b)(2).

¹³³ Mountain Water District's Response to AG 1-55.

¹³⁴ AG's Hearing Exhibit 1 (May 20, 2015). *See Also*: United States Census Bureau, State & County QuickFacts, <http://quickfacts.census.gov/qfd/states/21/21195.html>; VTE at 10:32:16 – 10:33:33.

¹³⁵ *Id.*; VTE at 10:25:32 - 10:26: 54.

¹³⁶ Mountain Water District's Response to AG 1-55. Mountain Water District's Response to AG 2-18; United States Census Bureau, Pike County, QuickFacts. <http://quickfacts.census.gov/qfd/states/21/21195.html>; VTE 10:33:35 - 10:33:50.

Administrator Sawyers further stated that even though the Board makes the final decision on employee salary increases, he would commit to make the recommendation that cessation and/or limitation of salary increases should be reviewed in order to improve the District's financial situation.¹³⁷ Although this commitment by the District Administrator is a step in the right direction, this admission supports that the District should have ceased or limited salary increases in order to improve its own financial health.

The District has admitted that it never performed a study to compare its salary, benefits, and raises per employee with the standard salary, benefits and raises of the workforce in the counties that it serves.¹³⁸ On the other hand, Mountain Water District submitted the KRWA Salary Range chart that demonstrates many of the positions are above the maximum salary range when compared to other water districts across the state.¹³⁹ Although Bob Meyers testified to certain inaccuracies within the chart, the chart as submitted does not include the District Administrator or the District Financial Administrator's salaries. Rather, it only includes the contractor UMG's salaries for direct comparison.¹⁴⁰ Thus, the District should not be able to rely on this evidence as proof that its salaries or raises are reasonable since it does not appear these positions were even included in the chart.

The Commission should consider adjusting Mountain Water District's revenue request to reflect more appropriate and justified salaries, and require the District implement a performance review system to award any potential raise. Additionally, a salary survey should be conducted to compare Mountain Water District's salary and wages, benefits, and raises per employee with the standard salary, benefits, and raises by the workforce in Pike County, which it services.

¹³⁷ VTE 10:35:16 – 10:35:30.

¹³⁸ VTE 10:31:37 – 10:32:09.

¹³⁹ VTE 10:14:30 – 10:16:07.

¹⁴⁰ VTE 11:53:20 – 11:54:03.

I. MOUNTAIN WATER DISTRICT'S LACK OF A NEPOTISM POLICY IS NOT REASONABLE.

The Attorney General contends that Mountain Water District should implement an anti-nepotism policy in order to cease any potential current or future nepotism.¹⁴¹ It is essential to have an anti-nepotism policy in place in order to prevent it from occurring at the workplace, since it is well known that there is a natural tendency for kinsman to favor kinsman if the opportunity presents itself. Consequently, it is absolutely vital to have an anti-nepotism policy in this case where the District's Board of Directors are in charge of not only two direct employees, but also has the power to award a multi-million dollar contract each and every year. Thus, any anti-nepotism policy should contain language that the Mountain Water District shall not, in the future, employ any person or persons who are related either by blood or by marriage, to any board member, manager, supervisor or other employee of the Mountain Water District, or of a third party contractor that in essence manages and operates the entire District. Finally, there should be no exception to the Nepotism Policy, whereby the Board of Commissioners can essentially override the letter and spirit of the policy, via a Board Resolution which would render it ineffective.

J. MISCELLANEOUS REVENUE REDUCTIONS

Throughout this process, many corrections, additions and alterations needed to be provided to garner an accurate assessment of the reasonableness of Mountain Water District's request for an increase in its water and sewer rates.¹⁴² The District's lack of consistent responses to Requests for Information, and at times, its corresponding contradictory answers have complicated the review process. Also, contained within the application for a rate increase are

¹⁴¹ Mountain Water District's Response to AG 1-7; Mountain Water District's Response to AG 2-9.

¹⁴² VTE 13:33:33; Refer to the Mountain Water District case including the Application, Request for Information Responses, and Public Hearing generally.

various items that are not allowed to be recouped by the District, and should be disallowed by the Commission, including various incidental expenditures that bear no rational relationship to the provision of water to ratepayers.

Additionally, the arbitrary 3 percent increase in electric rates, based upon an anticipated decision in Kentucky Power's pending rate case should be disallowed.¹⁴³ As the District has performed its revenue analysis on an historic test year for their Application, it must follow the general ratemaking principal that allows for "pro forma adjustments for known and measurable changes to the test year operations."¹⁴⁴ A pending rate case for the electricity supplier of the District is neither known nor measurable, and is purely speculative, and as such that amount should be reduced, and the 3% increase disallowed.

III. CONCLUSION

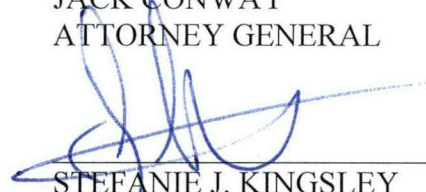
WHEREFORE, based on the factual record, legal analysis and the reasons set forth in this brief, the Attorney General recommends that Mountain Water District's application for a revenue increase of over \$3.6 million dollars should be denied due to the fact that the District did not meet the required burden of proof. Further, the proposed rate increases of 25 percent for water and 159 percent for sewers are unfair, unjust, and unreasonable. If the Commission is inclined to grant a rate increase, then it should be limited to what Mountain Water District has proven with known and measurable evidence that will result in fair, just, and reasonable rates for the District's ratepayers.

¹⁴³ Mountain Water District Response to AG 2-41 and Application, Exhibit Tab F.

¹⁴⁴ 807 KAR 5:076 Section 9. *In re: Application of Water Service Corporation of Kentucky for an Adjustment of Rates*, 24 July 2014, Order (Ky. PSC 2013-00237). See also, *In re Madison County Utility District*, 27 January 2003, Order (Ky. PSC 2002-184) and *In re: Application of Big Rivers Electric Corporation for a General Adjustment in Rates*, 17 November 2011, Order (Ky. PSC 2011-00036).

Respectfully submitted,

JACK GONWAY
ATTORNEY GENERAL

A handwritten signature in blue ink, appearing to be 'Stefanie J. Kingsley', is written over a horizontal line.

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