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JUN 29 2015

PUBLIC SERVICE
COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

In the Matter of:

Proposed Adjustment of the Wholesale)	
Water Service Rates of)	Case No. 2014-00392
the City of Danville)	

BRIEF OF THE CITY OF DANVILLE

The City of Danville (“City” or “Danville”) seeks approval of an increase in wholesale water rates. Specifically, the City seeks to adjust its water rate to Parksville Water District to \$2.68 per thousand gallons and Garrard County and Lake Village Water Associations to \$2.41 per thousand gallons, plus an additional amount to recover rate case expense.¹

I. Background

The City of Danville provides wholesale water service to three utilities under the jurisdiction of the Public Service Commission: Parksville Water District (“PWD”), Garrard County Water Association (“GCWA”), and Lake Village Water Association (“LVWA”). The City has effectively had the same rate to these entities for more than 15 years.² During this time period, the City’s retail customers have faced annual rate increases, including a 46% increase in 2011.³ As one would expect, operational expenses (personnel costs, electrical, chemical, maintenance, etc.)⁴ for a water utility have increased significantly over the past 15 years. In addition, the City is nearing completion of significant upgrades to its water treatment plant to

¹ The City also seeks to continue to charge an extra line item pass-through rate for the Kentucky River Authority fee.

² Video Recording Transcript of June 3, 2015, hearing (“VR”) at 10:06:55.

³ Direct Testimony of Earl Coffey at 4:2.

⁴ VR: 10:07:00-10:10:00.

ensure that it can continue to serve as a producer of potable water in the region. These upgrades have required the City to incur significant debt, which in turn increases the debt-service component of rates.⁵

In 2009, an engineering consulting firm prepared the City's Water Master Plan, which acknowledged the need for increased treatment facilities.⁶ While this plan was being prepared, the City met with the wholesale customers to discuss their future demands.⁷ In 2011, the City informed the wholesale customers that the retail rates had been increased and that the wholesale rates would be increased.⁸

In 2014, the City retained Salt River Engineering to perform a cost-of-service study. The City wanted to develop cost-based rates to minimize any customer-class subsidies.⁹ The City waited until after the construction costs for the upgrades to the water treatment plant were finalized and financing was approved to provide that information to Salt River Engineering to ensure that all costs associated with the project that were included in rates were known and measurable.¹⁰ Connie Allen, P.E., of Salt River Engineering, completed the initial work on the cost-of-service study in July 2014.¹¹

In order to ensure transparency, the City and Ms. Allen met with its four¹² wholesale water customers on July 23, 2014, to notify them about the proposed rate increase and to discuss the information on which the proposed rates were based.¹³ They had subsequent individual

⁵ VR: 10:10:30-10:11:00.

⁶ See VR: 10:11:12; see also Water Master Plan, attached to the City's Responses to Commission Staff's First Requests for Information, Item 5.

⁷ VR: 10:13:10-10:13:20.

⁸ VR: 10:13:30-10:13:40.

⁹ Direct Testimony of Connie Allen at 9:19-20.

¹⁰ VR: 10:14:00-10:14:10.

¹¹ VR at 10:14:15.

¹² The fourth wholesale customer is the City of Hustonville, which is a non-jurisdictional transaction. VR: 10:37:09. The City has already increased its rate to Hustonville to be consistent with the findings of the cost-of-service study.

¹³ Direct Testimony of Earl Coffey at 5:20-21.

meetings with the wholesale customers in August and September 2014.¹⁴ As a result of those meetings, the City recognized that an adjustment to the study was necessary and the proposed rate for PWD was lowered from \$2.71 to \$2.68.¹⁵ The only other discussions PWD had with the City was to encourage the City to lower the PWD rate to an figure closer to the other wholesale customers,¹⁶ but the City declined to move away from cost-based rates.

On August 20, 2014, the City issued letters to each of the wholesale water customers, suggesting that the City Commission approved increased rates to be effective on September 1, 2014.¹⁷ The City, however, did not implement the proposed rates on September 1. Rather, the City's ordinance specifically stated that the rates would go into effect on "September 1, 2014, or as soon thereafter as each wholesale water purchase contract will allow and is practicable."¹⁸ The contracts between the City and the three Commission-jurisdictional wholesale customers provide for a 90-day notice period to the wholesale customer. If a customer objects, the City may submit its proposed rate to the Commission for approval with less than 90 days' notice.¹⁹

On August 28, 2014, PWD filed a Complaint with the Commission, objecting to the City's proposed increase.²⁰ It argued that the City did not provide proper notice under the contract and that the City failed to comply with Commission regulations pertaining to proper notice for an increased rate. PWD also stated that it "believes the increase is not reasonable."

¹⁴ The City met with GCWA on August 11, 2014; PWD on August 21, 2014; and LVWA on September 5. Direct Testimony of Earl Coffey at 6:1-3. PWD manager Jerry Feather testified that the PWD board members may not have taken full advantage of these meetings by asking any questions to the City representatives. VR: 11:47:00-11:47:20. PWD never provided the City with a list of concerns related to the City until filing its Complaint with the Commission. VR: 11:52:00.

¹⁵ VR: 11:28:24.

¹⁶ VR: 11:53:00.

¹⁷ See Letters dated August 20, 2014, attached to the City's Responses to the Commission's Order Issued November 14, 2014, Item 27.

¹⁸ See Ordinance 1842, attached to the City's Responses to the Commission's Order Issued November 14, 2014, Item 27.

¹⁹ See Agreements dated June 1, 2009, attached to the City's Responses to the Commission's Order Issued November 14, 2014, Item 28.

²⁰ This Commission established Case No. 2014-00314 for this matter and subsequently consolidated that case into the present matter.

On September 29, 2014, the City responded to PWD's complaint and stated, *inter alia*, that the City had not implemented the proposed increase and implied that it would not implement the proposed rates until authorized by law. The City further stated that "[i]f any future proposed rate increase by the City is incorporated into this proceeding for a determination on the reasonableness of the City's wholesale rates, the City requests a surcharge for reasonable rate case expense."

On October 16, 2014, GCWA filed a complaint with the Commission, also alleging that the City did not provide proper notice under the contract and that the City failed to comply with Commission regulations pertaining to proper notice for an increased rate.²¹ The City filed an Answer to the GCWA's Complaint on October 30, 2014, stating that it did not increase rates on September 1, 2014, and implying that it would not increase rates until authorized by law. The City also stated that it "requests a surcharge added to its rate to recoup the costs it incurs for reasonable expenses associated with an investigation into the reasonableness of its rates."

On October 17, 2014, the City filed proposed wholesale rates with the Commission. The City proposed rates of \$2.68 per 1,000 gallons for PWD and \$2.41 for GCWA and LVWA, which was consistent with the cost-of-service study. Because no litigation expense had been incurred at the time of the cost-of-service study, the City did not artificially inflate rates to include rate case expense. The notice provided to customers when the City filed its proposed rates with the Commission stated that "the Public Service Commission may order rates to be charged that differ from the proposed rates contained in this notice." The rates were proposed to go into effect on November 19, 2014.

On November 14, 2014, the Commission suspended the effective date of the proposed rates through April 18, 2015. The Commission and its Staff issued a total of three written

²¹ This Commission established Case No. 2014-00361 for this matter and subsequently consolidated that case into the present matter.

requests for information on Danville during the discovery phase. In April, GCWA indicated that it had no objection to the rate of \$2.41 if it went into effect in May 2015.²² An evidentiary hearing was held on June 3, 2015.

II. Analysis

A. Revenue Requirements – Water Treatment Plant

The City has included expenses related to the upgrades to its water treatment plant that is currently in progress and nearing completion. This project is estimated to cost a total of \$28,608,171, which is financed from three primary sources. It has a series of loans from the Kentucky Infrastructure Authority with an aggregate amount of \$12,467,849. The U.S. Department of Agriculture, Rural Development (“RD”), has committed \$15,000,000 in loans, of which the City has already issued \$13,600,000 in bond anticipation notes. These notes are backed by RD and will be paid off by the proceeds of the RD loans on or before they become due in August 2016. The City has also paid \$1,140,322 from its Utility Fund towards this project.²³

The City is entitled to recover debt and depreciation expense for this project. No party to this proceeding has questioned the need for the project or its costs. The City presented its Water Master Plan, which acknowledged the need for increased treatment facilities.²⁴ Moreover, all of the City’s expenses are known and measurable. It has contracts for the work to be performed, and it has the financing for the project, which it will be required to pay. In addition, the City is currently paying interest on the funding that it has received.²⁵ The Commission has traditionally allowed water utilities to include debt and depreciation expense for a proposed construction

²² See Documents filed into the record on April 14, 2015.

²³ The amount paid from its Utility Fund does not include expenses for interest previously paid on draws on the financing accounts.

²⁴ Water Master Plan, attached to the City’s Responses to Commission Staff’s First Requests for Information, Item 5.

²⁵ VR: 11:05:00.

project into rates.²⁶ Accordingly, the Commission should allow the City to recover its expenses associated with the water treatment plant project.

B. Revenue Requirements - Transmission and Distribution Lines

Using AWWA's methodology, Danville assigned 50 percent of the total cost associated with distribution mains to all its customers, including wholesale customers, and further allocated those costs by each customers' CAP-1 factor. This results in the wholesale customers only paying a small percentage of the total costs of the distribution lines. In addition to water flowing through the distribution lines to reach wholesale customers, these customers benefit from distribution lines in a variety of ways:

- small diameter lines often complete loops within water distribution systems;
- looping dead-end lines serve to normalize pressure and avail increased flow volumes;
- looping dead-end lines increases water quality by encouraging turnover;
- grids formed by the distribution lines are called upon to move water in a supplemental role during periods of peak demands and when the larger lines are valved-off for maintenance or repair; and
- distribution lines feed the direct customer base which contributes to the economy of scale the wholesale customers enjoy.²⁷

Moreover, the Commission has previously allowed the Frankfort Electric and Water Plant Board to recover costs for distribution mains.²⁸

PWD suggests that Danville should not be entitled to recover for these expenses because Danville did not complete a hydraulic study to show the benefit of the distribution lines to the wholesale customers. Danville provided a hydraulic analysis in response to Item 3 of the

²⁶ See, e.g., Hardin Cnty. Water Dist., Case No. 2001-00211, at 4-5, 18-19, 21.

²⁷ City's Responses to Commission Staff's First Request for Information, Item 18.

²⁸ See Frankfort Elec. And Water Plant Bd., Case No. 2008-00250 at 10-11.

Commission Staff's First Request for Information, and the analysis demonstrates that water flows through distribution lines to reach PWD's system. This analysis demonstrates that distribution lines should be allocated to the wholesale customers. More importantly, the benefits articulated above provide a better narrative of why those expenses should be allocated to Danville's wholesale customers.

C. Revenue Requirements – Rate of Return

Included within the proposed rates, the cost-of-service study included a 2.0% rate of return.²⁹ Connie Allen testified that the appropriate rate of return should have been significantly higher.³⁰ Allen also testified that the City was cognizant of rate shock³¹ and using the appropriate rate of return “would nearly quadruple the increase in the return on rate base.”³² Accordingly, a lower rate of return was utilized in the cost-of-service study than would otherwise be necessary. No party questioned or challenged Allen's testimony on the appropriate rate of return.

If the Commission reduces or otherwise eliminates any component of the City's pro forma revenue requirements below the amount requested to be recovered from the wholesale customer, the Commission should increase the rate of return to an appropriate level—between 5.6% and 6.5% according to the testimony in this case.

D. Rate Design - CAP-1 Peaking Factor for Parksville Water District

In the cost-of-service study, Connie Allen calculated a peaking factor of 2.0 to PWD, which is lower than the typical peaking factor for residential customers.³³ Unlike a normal

²⁹ City's Responses to the Commission's Order Issued November 14, 2014, Item 21 (“Danville is requesting a 2.0 rate of return from its wholesale customers as shown in Line No. 6.”).

³⁰ Direct Testimony of Connie Allen at 9:1-2 (stating that “three methods revealed that the rate of return should be 6.5%; 5.7%; and 5.6%.”).

³¹ VR: 11:29:48.

³² Direct Testimony of Connie Allen at 9:1-2.

³³ Direct Testimony of Connie Allen at 5:17-18.

diurnal-usage pattern, PWD's pumps (their demand) are either on or off.³⁴ Accordingly, she calculated the peaking factor for PWD by dividing the maximum daily demand by the average daily demand.³⁵ The maximum daily demand was determined based on information that the pumping capacity was 450 gallons per minute ("gpm").

PWD maintains that it is inappropriate to calculate the maximum pumping capacity based on 450 gpm, arguing that neither of the two pumps has previously operated at that rate. This fact, however, is not dispositive of the issue. AWWA policy dictates and the City's expert opines that peaking factor should be designed based on the pumping capacity of the wholesale customer.³⁶ Further, rates should be designed based on the design capacity of facilities, as the City Engineer testified.³⁷ In other words, a utility must be allowed to recover for their entire facility (if appropriately designed) even if it is not used at capacity during the initial period.

The City's reliance on the maximum design capacity of PWD's pumping station is reasonable. City Engineer Earl Coffey had discussions with PWD's engineer Chris Stewart, who informed Coffey in 2012 that PWD was considering upgrading the capacity of the pumping station to 400-500 gpm.³⁸ Shortly thereafter, PWD upgraded the piping at the Lebanon Road pump station in October 2014.³⁹

More importantly, however, PWD has admitted that there are two pumps at the Lebanon Road pump station that both have a stated capacity of 450 gpm.⁴⁰ When PWD upgraded the piping at the pump station in October 2014,⁴¹ there was a noticeable increase in the average

³⁴ Direct Testimony of Connie Allen at 5:18.

³⁵ Direct Testimony of Connie Allen at 5:21-6:1.

³⁶ See City's Responses to the Request for Information from the Informal Conference, Item 1 (filed April 20, 2015).

³⁷ VR: 10:47:15-10:48:56.

³⁸ VR: 10:42:20-10:44:00.

³⁹ VR: 11:49:35.

⁴⁰ See PWD's Response to Commission Staff's Request for Information ("[T]he stated maximum pumping capacity of this pumping station is 450 gallons per minute . . ."); VR: 11:41:18; 12:20:00.

⁴¹ VR: 11:49:35.

gallons pumped per hour by PWD from the City.⁴² Although PWD has suggested that they have not pumped greater than 335 gpm from a single pump at that station, there has been no specific documentation of minute-by-minute reports. Moreover, PWD has not specifically stated whether it has ever run both pumps at the pump station at the same time. Even if either single pump could not pump at 450 gpm, running both pumps at the same time could easily exceed that flow rate.⁴³

PWD maintains that it cannot run a pump at the Lebanon Road pump station at 450 gpm because there would be no place for the water to go. This is simply inaccurate. PWD has fire hydrants in the area,⁴⁴ and the water could be used for fire protection and flushing the system.⁴⁵ It could also be used by customers that are served by water directly from the pump station. In addition, PWD manager Jerry Feather indicated in his testimony that the water from the Lebanon Road pump station could flow to the other pump stations and into PWD's storage tanks. He stated: "If one of the other pump stations filled its tank and shut off and then it [Lebanon Road station] was still pumping 450 [gpm], there's nowhere else for that water to go."⁴⁶ This statement indicates that water could be routed to the other pump stations when they are operating to fill their tanks if PWD were drawing at 450 gpm from the City's system.

It should also be noted that Parksville has ultimate control over its peaking factor. For example, GCWA and LVWA were assigned a lower peaking factor because they draw water from the City's system without the requirement for pumping.⁴⁷ In other words, GCWA and LVWA have a typical diurnal usage pattern, but have a buffer (water storage) between the

⁴² PWD's Responses to the Request for Information from the Informal Conference (filed May 4, 2015).

⁴³ In addition, the average per minute flow rates identified in PWD's Responses to the Request for Information from the Informal Conference (filed May 4, 2015) assume that only one pump is running at any given time. If both pumps were running, the average gallons per minute would increase greatly. For example, if both pumps ran at the same time in December 2014, the average gallons per minute would be 556 gpm instead of 288.

⁴⁴ VR: 11:49:15

⁴⁵ PWD must flush its system frequently. VR: 12:02:30

⁴⁶ VR: 11:42:32-11:42:44.

⁴⁷ Direct Testimony of Connie Allen at 6:2-3.

metering point and their customers. Using AWWA methodology and principles utilized by Connie Allen, PWD could lower its peaking factor in different ways. It could construct a ground storage tank between the pumping station and the point of connection of the two systems. PWD could also increase its average demand from the City, which is the divisor in the calculation of the peaking factor, thereby reducing the quotient (i.e., peaking factor) in the calculation. Increasing the volume purchased from Danville increases the denominator in the cost-per-gallon calculation, thereby decreasing the rate charged to Parksville. These are just two of the many methods by which PWD can impact the rate at which it purchases water.

Ultimately, the City's use of a 2.0 peaking factor for PWD is reasonable because it is consistent with AWWA standards to utilize the potential capacity of the pump as compared to current usage, as suggested by PWD. It should also be noted, though, that any change in peaking factor is a revenue-neutral change. Thus, if the Commission determines that it is reasonable to lower the peaking factor for PWD, the rates for GCWA and LVWA will increase.

E. Surcharge - Rate Case Expense

The City is requesting that the Commission approve a 36-month surcharge to recoup rate case expenses. Specifically, it is seeking to recover the allocated expense associated with the cost-of-service study based on total percentage of revenue requirements.⁴⁸ The City is also requesting that the utilities that are parties to this case be allocated an equal portion of the \$57,190.69 total litigation expense.⁴⁹

⁴⁸ This is consistent with the Commission's ruling in City of Hopkinsville, Case No. 2009-00373 at 8 (Ky. PSC July 2, 2010).

⁴⁹ See City's Post-Hearing Data Responses (filed June 15, 2015).

	Parksville Water District	Garrard County Water Association	Lake Village Water Association
Cost-of-Service Study	\$1,513.26	\$1,018.03	\$1,610.50
Litigation Expense	\$28,595.35	\$28,595.35	
Total Expenses	\$30,108.61	\$29,613.38	\$1,610.50
36-month Amortization	\$836.36	\$822.60	\$47.50

The only claim that the total amount of expenses was unreasonable related to the amount charged by the consultant for amending the cost-of-service study at the request of Commission Staff. Each of these changes was made at the request of Commission Staff, as opposed to the City. The changes were designed to input new or different data into the existing cost-of-service study, which each of the parties could have accomplished themselves. More importantly, it was a part of the process by which the City was defending the reasonableness of the rates that it had proposed to its wholesale customers. The U.S. Supreme Court has clearly stated “[e]ven where the rates in effect are excessive, on a proceeding by a commission to determine reasonableness, we are of the view that the utility should be allowed its fair and proper expenses for presenting its side to the commission.”⁵⁰ This Commission has adopted the Supreme Court’s position.⁵¹ Thus, the entire amount of the rate case expense is reasonable.

Questions were raised as to the notice that Danville provided to each of the wholesale customers. First and foremost, the Commission must take notice that the City was attempting to keep the rate as low as possible by not including any projected rate case expense in its proposed rates. If the Commission rules that municipalities must start including projected rate case expense in proposed wholesale rates, the proposed rates will be unnecessarily high and will

⁵⁰ Driscoll v. Edison Light & Power Co., 307 U.S. 104, 120-21 (1939).

⁵¹ Campbell Cnty. Water Dist., Case No. 89-029 (Ky. PSC Mar. 6, 1990).

essentially force wholesale customers to protest the proposed rate and seek a Commission investigation.

Notice was provided to each of the wholesale customers that the City would or could seek rate case expense. In addition to verbal conversations, the City provided notice to PWD and GCWA that it would seek rate case expense in its answers to their complaints filed before this matter was established.⁵² These Answers were filed before the Commission initiated this matter.

In addition, the City provided a discovery response to the Commission's Order dated November 14, 2014, indicating that it was seeking to recover rate case expense in this matter.⁵³ All wholesale customers had either actual or constructive notice of this discovery response. PWD and GCWA received a copy of this response. LVWA was on constructive notice of this response because the Commission served a copy of its November 14, 2014, order on LVWA's Executive Director. LVWA had notice that this matter was pending and that the question was posed to the City.

More importantly, every wholesale customer received a copy of a notice that specifically stated that "the Public Service Commission may order rates to be charged that differ from the proposed rates contained in this notice." This statement recognizes that the administrative proceeding before the Commission may result in higher rates to the customers. If the Commission were to determine that the City could not recover rate case expense because of lack of notice, the Commission would be rendering this provision of the regulation-required notice meaningless.

⁵² See City's Answers in Case No. 2014-00314 ("If any future proposed rate increase by the City is incorporated into this proceeding for a determination on the reasonableness of the City's wholesale rates, the City requests a surcharge for reasonable rate case expense.") and Case No. 2014-00361 ("The City also requests a surcharge added to its rate to recoup the costs it incurs for reasonable expenses associated with an investigation into the reasonableness of its rates.").

⁵³ See City's Responses to the Commission's Order Issued November 14, 2014, Item 24.

A third issue related to rate case expense that was mentioned during the proceeding was whether it was appropriate to recover these expenses as a surcharge or imbedded in rates. The Commission has found that either is a reasonable mechanism to recover rate case expenses for a municipally-owned utility. Because the Commission has specifically found that a surcharge is reasonable for the City of Greensburg⁵⁴ and Hopkinsville Water and Environment Authority,⁵⁵ the Commission should find that the surcharge is reasonable for the City of Danville.⁵⁶

III. Conclusion

The evidence in the record of this matter demonstrates that the City's proposed wholesale rates are fair, just, and reasonable. In fact, LVWA never challenged the reasonableness of the proposed \$2.41-per-1,000-gallon rate, and GCWA has now accepted it.⁵⁷ Initially, PWD was only concerned with getting its rate closer to the other customers,⁵⁸ as opposed to having a cost-based rate. Because there were complaints by PWD and GCWA, the Commission established this proceeding and the City incurred rate case expenses, which are properly recoverable in the form of a surcharge, as previously determined by the Commission. Accordingly, the City requests that the Commission authorize the City to charge the following rates:⁵⁹

Parksville Water District	\$2.68 per 1,000 gallons + \$836.36 for 36 months
Garrard Co. Water Ass'n	\$2.41 per 1,000 gallons + \$822.60 for 36 months
Lake Village Water Ass'n	\$2.41 per 1,000 gallons + \$47.50 for 36 months

⁵⁴ City of Greensburg, Case No. 2009-00428, at 7 (Ky. PSC Aug 6, 2010).

⁵⁵ Hopkinsville Water and Environment Auth., Case No. 2009-00373, at 13 (Ky. PSC July 2, 2010).

⁵⁶ If the Commission overrules the Hopkinsville and Greensburg cases and determines that a rate-case-expense surcharge is no longer reasonable for municipalities, it should nevertheless allow the City of Danville to incorporate these expenses into its volumetric rates to wholesale customers.

⁵⁷ VR: 12:22:00-12:22:20.

⁵⁸ VR: 11:53:000.

⁵⁹ In addition to these rates, Danville seeks to retain its line item for the Kentucky River Authority fee, which is currently set at \$0.022 per 1,000 gallons.

Respectfully submitted,



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ATTORNEYS FOR THE CITY OF DANVILLE

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served via U.S. Mail, postage prepaid, to the following on June 29, 2015:

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