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July 15, 2015

Mr. Jeff Derouen
Executive Director
Kentucky Public Service Commission
Post Office Box 615
Frankfort, KY 40602-0615

RECEIVED

JUL 15 2015

PUBLIC SERVICE
COMMISSION

Re: Case No. 2015-00155
Alleged Failure to Comply with KRS 278.300

Dear Mr. Derouen:

Larry Redden, Jerry Fields, Pamela Carpenter and David French (“Respondents”) have reviewed Commission Staff’s Memorandum of July 10, 2015 (“Memorandum”). This letter is submitted on their behalf, is intended to supplement the Memorandum, and expresses the positions that they presented at the conference of July 6, 2015.

Conference Attendance. Mr. Redden and Ms. Carpenter were unavailable to attend or participate by telephone in the conference. Mr. Redden was on a previously scheduled trip outside of Kentucky and had departed from the state prior to the scheduling of the conference. Ms. Carpenter is self-employed and could not attend or participate without incurring substantial financial hardship. Both conferred with legal counsel prior to the conference and provided instructions regarding the conference.

History. At start of the conference, Mr. Fields and Mr. French described the circumstances surrounding the issuance of the promissory notes to the Bank of Maysville. In 2003 Western Mason County Water District (“Western District”) engaged a new accountant. Upon reviewing Western District’s records, this accountant discovered that Western District had failed to correctly withhold and pay federal taxes from its employees’ wages. Based upon the accountant’s advice, Western District reported the error to the Internal Revenue Service and negotiated a settlement. To pay its tax obligations due to this error, Western District issued a promissory note for \$45,030 to the Bank of Maysville which was payable in one year. Despite its best efforts, Western District was unable to make full payment on the note. Each year from 2004 to 2011, when the existing promissory note became due and payable, Western District issued a new one-year promissory note to the Bank of Maysville for the remaining amount owed plus any additional amounts required to meet necessary expenditures. In January 2011, the Bank

of Maysville required that Western District issue a 10-year promissory note rather than a one-year promissory note. In January 2014, when Western District required additional funds to meet necessary expenditures, it issued a 10-year note in the amount of \$86,374 and used a portion of that note's proceeds to retire the 2011 promissory note.

Western District used all proceeds from the promissory notes to meet expenses necessary to provide water service to its customers. On two separate occasions, Commission Staff has extensively reviewed Western District's financial records in general rate case proceedings.¹ On neither of these occasions did Commission Staff find that Western District's use of the notes' proceeds to be improper, unlawful or unreasonable. At the conference, Respondents inquired whether Commission Staff questioned Western District's use of the proceeds or had any evidence that Western District had used the proceeds for unreasonable, unlawful or non-utility purposes. Commission Staff responded that they had no such evidence.

Although Western District did not obtain Commission approval of the notes, its issuance of notes met the standards set forth KRS 278.300 for such approval. Western District issued each promissory note for a lawful object within its corporate purposes. The issuance of each note was necessary for and consistent with Western District's proper performance of its service to the public. Issuance of the promissory notes did not impair Western District's ability to serve the public and were reasonably necessary and appropriate for its provision of utility service.

None of the debt service costs associated with the promissory notes appears to have been included in Western District's rates or recovered from Western District's ratepayers. Western District has twice applied for a general rate adjustment since 2003.² Finding that inclusion of debt service costs on the promissory notes to the Bank of Maysville would constitute retroactive ratemaking, Commission Staff recommended in Case No. 2006-00015 that the costs not be included in the calculation of Western District's rates.³ The Commission agreed.⁴ Commission

¹ Staff Report on Western Mason County Water District (Mar. 21, 2006) ("2006 Staff Report") filed in Case No. 2006-00015, *The Application of Western Mason County Water District for a Rate Adjustment Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC filed Jan. 10, 2006); Staff Report on Western Mason County Water District (Mar. 24, 2015) ("2015 Staff Report") filed in Case No. 2014-00420, *Alternative Rate Adjustment Filing of Western Mason County Water District* (Ky. PSC filed Dec. 23, 2014).

² In addition to these two general rate proceedings, Western District's rates were adjusted in two proceedings under KRS 278.023. Case No. 2007-00318; *The Application of the Western Mason County Water District, A District Organized Pursuant to Chapter 74 of the Kentucky Revised Statutes, In Mason County, Kentucky, For (1) A Certificate of Public Convenience and Necessity, Authorizing and Permitting Said Western Mason County Water District to Construct Water Distribution System Improvements, Consisting of the Construction of Extensions, Additions and Improvements to the District's Water System; (2) The Approval of the Proposed Plan of Financing Said Improvements; and (3) An Increase in the Rates and Charges for Water Service Provided By Western Mason County Water District* (Ky. PSC Aug. 3, 2007); Case No. 2009-00477, *Application of Western Mason County Water District for a Certificate of Public Convenience and Necessity to Construct Water Distribution System Improvements, Approval of the Proposed Plan of Financing and An Increase In Rates And Charges* (Ky. PSC Jan. 6, 2010).

³ 2006 Staff Report, Attachment A at 2-3.

⁴ Case No. 2006-00015, *The Application of Western Mason County Water District for a Rate Adjustment Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC Apr. 19, 2006) at 2.

Staff made a similar recommendation in Case No. 2014-00420, which the Commission also accepted.⁵

Nature of the Charged Offense. Throughout the Memorandum, Commission Staff refers to Respondents' "alleged failure to comply with KRS 278.300(1)." The Commission in its Order of June 9, 2015, however, does not allege that Respondents failed to comply with KRS 278.300. It found instead that "a prima facie case has been made that [the Respondents] . . . **willfully aided and abetted**" Western District's failure to obtain Commission authorization prior to issuing a promissory note to the Bank of Maysville on January 10, 2014.⁶ Since KRS 278.300(1)⁷ applies only to a "utility" and as none of the Respondents are a utility,⁸ Respondents cannot violate KRS 278.300(1). The Memorandum's references to Respondents' "alleged violations of KRS 278.300" are incorrect.

The Commission in its Order of June 9, 2015 did not identify the specific conduct in which each Respondent engaged that constituted aiding and abetting. The Commission stated only:

Pursuant to KRS 74.020(1), "A water district shall be administered by a board of commissioners which shall control and manage the affairs of the district." The Commission finds that a prima facie case has been made that Western Mason District commissioners Pam Carpenter, secretary; Jerry Fields, treasurer; Larry Redden, chairman; and Western Mason District manager David French, acting in their respective individual capacities as current members of Western Mason District's Board of Commissioners, or as the utility's manager, willfully aided and abetted in the above violation.⁹

Such findings are also absent from the Commission Staff Report in Case No. 2014-00421. A review of that report contains no mention of any specific action on the part of any Respondent that aided or abetted the alleged violation. Thus, the only evidence cited for the Commission's initiation of its proceeding is the Respondents' membership on Western District's Board of Commissioners.

⁵ 2015 Staff Report at 19; Case No. 2014-00420, *Alternative Rate Adjustment Filing of Western Mason County Water District* (Ky. PSC May 15, 2015) at 3 (Finding Paragraph 4).

⁶ Order of June 9, 2015 at 2 (emphasis added). In the Memorandum, Commission Staff also refers to a promissory note issued on January 10, 2014. Western District issued a note to the Bank of Maysville on January 17, 2014. Commission Staff refers to this note in its report. See 2015 Staff Report at 18. Respondents have no knowledge of any note issued on January 10, 2015.

⁷ KRS 278.300(1) provides:

No utility shall issue any securities or evidences of indebtedness, or assume any obligation or liability in respect to the securities or evidences of indebtedness of any other person until it has been authorized so to do by order of the commission.

⁸ See KRS 278.010(3) (defining "utility for purposes of KRS 278.010 through KRS 278.450).

⁹ Order of June 9, 2015 at 2.

As the “essential element of aiding and abetting the commission of any act is assisting and taking an active part in it”¹⁰ and as membership on Western District’s Board of Commissioners is not an act but a status, Respondents requested that Commission Staff identify for each Respondent the specific actions that support the finding of willful aiding and abetting a violation of KRS 278.300. They also questioned how KRS 74.020 could serve as the basis for the Commission’s finding regarding Mr. French. Mr. French is not a member of Western District’s Board of Commissioners and had no authority to enter into any loan agreement with the Bank of Maysville.¹¹ He did not sign any promissory note. As he was not a member of the Board of Commissioners, he could not and did not vote on the any motion to authorize the water district’s execution of a promissory note. Commission Staff did not identify any action in responding to these inquiries.

Willful Violation. At the conference, the Respondents noted that any violation that Western District or the Respondents may have been committed was done unknowingly and without willful intent. Mr. Fields and Mr. French stated that they and the other Respondents were not familiar with the requirements of KRS 278.300 and believed that prior Commission approval was required only if a utility was issuing bonds or was borrowing funds to construct facilities. No Respondent has a legal or financial background. Mr. Fields is a retired office worker; Ms. Carpenter is a barber; Mr. Redden is an electrician. Prior to issuing the promissory notes to the Bank of Maysville, the Respondents did not consult with legal counsel. Due to its limited financial resources and in an effort to reduce costs, Western District during this period did not have legal counsel and retained legal counsel only when a construction project or bond issuance was involved.

The Respondents relied upon the Bank of Maysville to advise Western District of any required regulatory approvals.¹² Their reliance was not unreasonable under the circumstances. The Bank of Maysville has been in existence since 1835 and is the oldest independent bank in Kentucky. It has significant experience and expertise in the lending and could be presumed to be aware of any statutory requirements related to lending funds to a public utility. Moreover, the Bank of Maysville had a direct financial interest in ensuring the promissory notes were properly executed and in accordance with all state laws. At no time did the Bank of Maysville advise

¹⁰ *Kendall v. Beiling*, 175 S.W.2d 489, 495 (Ky. 1943).

¹¹ As Western District’s General Manager, Mr. French is subordinate to Western District’s Board of Commissioners. See KRS 74.040.

¹² There is no evidence that Commission Staff had previously advised Western District that KRS 278.300 required Commission approval if a promissory note for a period of less than two years was refunded or renewed for an aggregate term exceeding six years from the date of the original note. Based upon its report to the Commission in Case No. 2006-00015, however, Commission Staff was aware of Western District’s repeated refunding and renewal of the 2003 Note. 2006 Staff Report, Attachment A at 2-3. In its report, Commission Staff stated that “[t]his debt was not required to be approved by the PSC under Kentucky statutes . . .” *Id.* at 3. Presumably, Commission approval was not required because the note had only been renewed three times and only three years had lapsed since the issuance of the original note. In other proceedings, however, the Commission or Commission Staff has warned of the requirements of KRS 278.300 and the need for Commission authorization. See, e.g., Staff Report on Classic Construction (Oct. 31, 2013) filed in Case No. 2013-00258, *The Application of Classic Construction, Inc. for a Rate Adjustment for Small Utilities Pursuant to 807 KAR 5:076* (Ky. PSC filed July 2, 2013); Case No. 2014-00277, *Springcrest Sewer Company, Inc. Request For Deviation From 807 KAR 5:071, Section 7(4)* (Ky. PSC Dec.16, 2014).

Western District or the Respondents that Commission authorization was required before any promissory notes could be issued.

The conduct of Western District and the Respondents does not support the finding of a willful violation of KRS 278.300 or of aiding and abetting a willful violation of that statute. Western District has no previous history of violating KRS Chapter 278 or Commission regulations. Neither Western District nor the Respondents have made any effort to conceal or hide the existence of any of the promissory notes issued to the Bank of Maysville. Western District consistently reported these notes in its annual reports to the Commission. When applying to the Commission for a rate adjustment, it included a copy of the most recently issued note with its application and expressly identified the promissory note as a reason for the requested rate adjustment. Any entity that had knowingly and willfully failed to comply with KRS 278.300 would not have reported that violation annually to the Commission or directed the Commission's attention to the violation.

The Commission has previously found that a willful violation means a knowing violation or knowing failure to comply.¹³ The available evidence clearly demonstrates that Respondents did not knowingly or willfully take any action to violate KRS 278.300 or cause Western District to violate KRS 278.300. This lack of knowledge prevents any finding of a willful violation or the willful aiding and abetting of a violation on their part.

Exceptional Treatment. At the conference, Respondents noted that the Commission's actions regarding the alleged misconduct appeared inconsistent with past Commission precedent. Respondents' review of Commission records fail to reveal any Commission precedent for the initiation of show cause proceeding against utility officials for aiding and abetting a utility's alleged violation of a provision of KRS Chapter 278 while taking no action against the utility for the alleged violation. With regard to violations of KRS 278.300 by small water and sewer utilities, the Commission has on numerous instances taken no action other than to note the violation and verbally reprimand the utility.¹⁴ In cases involving larger and more sophisticated utilities that that have greater financial resources and employ legal counsel, the Commission has

¹³ Case No. 90-172, *Kentucky Utilities Company: Alleged Failure to Comply with Commission Regulations* (Ky. PSC Dec. 14, 1990) at 3.

¹⁴ See, e.g., Case No. 9100, *An Adjustment of Rates of Tree-Line Utilities, Inc. D/B/A Tree-Line Estates Sewage Treatment Plant* (Ky. PSC Apr. 26, 1986); Case No. 9226, *An Application of Lake of the Woods Sanitation, Inc. Adjustment for Small Utilities Pursuant to 807 KAR 5:076* (Ky. PSC May 30, 1985); Case No. 94-266, *The Application of The Mallard Point Disposal System, Inc. for an Adjustment of Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC Nov. 16, 1994) (taking no action on violation of KRS 278.300 noted in Commission Staff Report); Case No. 94-034, *The Application of Mockingbird Valley Sanitation, Inc. for a Rate Adjustment Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC Aug. 5, 1994) (taking no action on violation of KRS 278.300 noted in Commission Staff Report); Case No. 94-226; Case No. 2000-432, *The Application of Elam Utility Company Inc. for an Adjustment of rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC Mar. 14, 2001) (taking no action on violation of KRS 278.300 noted in Commission Staff Report); Case No. 2002-00395; Case No. 2005-00058, *Kentucky Infrastructure Authority's Joint Application on Behalf of Certain Water Districts for Authority to Borrow Funds to Refinance Certain Indebtedness to the Kentucky Infrastructure Authority* (Ky. PSC Aug. 26, 2005); Case No. 2008-00170, *The Application of Bullock Pen Water District for a Certificate of Public Convenience and Necessity to Construct Proposed Waterworks Improvement Project and For Approval of Proposed Plan of Financing, Increase In Rates, Nonrecurring Charges, and Tariff Revisions* (Ky. PSC Dec. 10, 2009).

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generally initiated enforcement proceedings for violations of KRS Chapter 278 against the utility, but not its officials.¹⁵

Failure to Serve Respondents. At the conference, Respondents noted that the Commission failed to serve a copy of its Order of June 9, 2015 on Mr. Redden, Mr. Fields or Ms. Carpenter. As clearly indicated on the Certificate of Service to the Order of June 9, 2015, a copy of the Order was addressed to and served on Western District and Mr. French only. KRS 278.380 provides: “The commission shall deliver a certified copy of any order issued by it to each party to the proceeding in which the order was made. . .” Mr. Redden, Mr. Fields, and Ms. Carpenter were clearly parties to this proceeding as the Commission directed each to respond to its Order and to appear before it. Western District was clearly not a party as the Commission chose not to order Western District to take any action with regard to the proceeding.¹⁶

Settlement Discussions. Commission Staff’s discussion in the Memorandum of settlement proposals that have not been accepted by all parties and that have not committed to writing in the form of a settlement agreement or stipulation is inappropriate and contrary to longstanding Commission practice. Moreover, the description of the proposal set forth in the Memorandum is incomplete and omits certain terms that are critical to a full understanding of the proposal.

In closing, I wish to thank Commission Staff for the opportunity to comment upon the Memorandum and to more fully explain the Respondents’ position on these matters.

Very truly yours,

Stoll Keenon Ogden PLLC



Gerald Wuetcher

GEW
Enclosure

¹⁵ See, e.g., Case No. 2007-00185, *Kentucky-American Water Company: Alleged Failure to Comply with KRS 278.300* (Ky. PSC 16, 2007); Case No. 2011-00160, *Owen Electric Cooperative, Inc.: Alleged Failure to Comply with KRS 278.020 and Commission Order* (Ky. PSC June 21, 2011); Case No. 2011-00376, *Nolin Electric Cooperative Corporation Alleged Failure to Comply with KRS 278.020* (Ky. PSC Oct. 17, 2011).

¹⁶ The Commission’s Rules of Procedure provide that service upon a party “shall be made by . . . [m]ailing a copy by United States mail or other recognized mail carrier to the . . . party at the last known address.” 807 KAR 5:001, Section 4(8). The Order was addressed and mailed to Western District, not Mr. Redden, Mr. Fields or Ms. Carpenter.

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

WESTERN MASON COUNTY WATER)	
DISTRICT COMMISSIONERS PAM)	
CARPENTER, SECRETARY; JERRY FIELDS,)	
TREASURER; LARRY REDDEN, CHAIRMAN;)	CASE NO.
AND MANAGER DAVID FRENCH)	2015-00155
ALLEGED FAILURE TO COMPLY WITH KRS)	
278.300(1))	

ORDER

On December 1, 2014, Western Mason County Water District ("Western Mason District") tendered its application for a rate adjustment pursuant to 807 KAR 5:076. This application was assigned Case No. 2014-00421.¹ After Western Mason District corrected filing deficiencies, the Commission accepted the application for filing on December 23, 2014.

The Commission issued an Order on January 12, 2015, establishing a procedural schedule. Pursuant to the procedural schedule, Commission Staff filed a Staff Report on March 24, 2015, after conducting a field review of Western Mason District's financial records. During its field review, Commission Staff discovered that Western Mason District has an outstanding ten-year note dated January 10, 2014, payable to the Bank of Maysville in the amount of \$86,374 for which the Commission's authorization was required pursuant to KRS 278.300 but was never sought or received by Western Mason

¹ Case No. 2014-00421, *Alternative Rate Adjustment Filing of Western Mason County Water District* (Ky. PSC May 15, 2015).

District. In the May 15, 2015 Order approving new rates for Western Mason District, the Commission stated that in addition to having issued this note without prior approval, Western Mason District had entered into three prior evidences of indebtedness, none of which are still outstanding, without prior approval.²

KRS 278.300(1) states that no utility shall issue any form of indebtedness unless it has been authorized to do so by an Order of the Commission. The Commission finds that a prima facie case has been made that in violation of KRS 278.300, Western Mason District obtained an \$86,374 loan for a term of ten years from the Bank of Maysville without obtaining an Order from the Commission authorizing Western Mason District to issue the indebtedness.

Pursuant to KRS 74.020(1), "A water district shall be administered by a board of commissioners which shall control and manage the affairs of the district." The Commission finds that a prima facie case has been made that Western Mason District commissioners Pam Carpenter, secretary; Jerry Fields, treasurer; Larry Redden, chairman; and Western Mason District manager David French, acting in their respective individual capacities as current members of Western Mason District's Board of Commissioners, or as the utility's manager, willfully aided and abetted in the above violation.

IT IS THEREFORE ORDERED that:

1. Western Mason District commissioners Pam Carpenter, secretary; Jerry Fields, treasurer; Larry Redden, chairman; and Western Mason District manager David French, individually in their respective capacities as current commissioners of Western Mason District, or as the utility's manager, shall submit to the Commission individual

² *Id.* at 2.

written responses to the allegations contained herein within 20 days of the date of this Order.

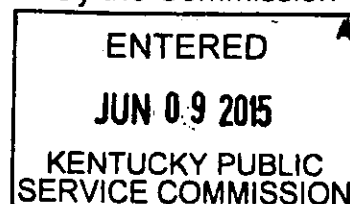
2. Western Mason District commissioners Pam Carpenter, secretary; Jerry Fields, treasurer; Larry Redden, chairman; and Western Mason District manager David French, individually in their respective capacities as current commissioners of Western Mason District, or as the utility's manager, shall appear at a hearing scheduled for Tuesday, August 25, 2015, at 10 a.m. Eastern Daylight Time, in Hearing Room 1 of the Commission's offices at 211 Sower Boulevard, Frankfort, Kentucky, and be prepared to show cause why they should not be subject to the penalties prescribed in KRS 278.990(1) for the alleged violation of KRS 278.300.

3. The August 25, 2015 Hearing shall be recorded by videotape only.

4. The record of Case No. 2014-00421 shall be incorporated into this case by reference only.

5. Any request for an informal conference, which may be held via phone with Commission Staff at the request of any of the above-named commissioners, or utility manager, to discuss the issues in this case, shall be set forth in writing and filed with the Commission within 20 days of the date of this Order.

By the Commission



ATTEST


Executive Director

*David French,
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