COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

PETITION OF MOUNTAIN WATER DISTRICT FOR MODIFICATION OF ORDER OF CASE 2014-00324	)))	Case No. 2016-00062

REPLY TO ATTORNEY GENERAL'S MOTION

The Attorney General (AG) objects to Mountain Water District's (MWD) petition for modification of the order issued in Case No. 2014-00342. The primary objection is predicated on the applicability of *res judicata*. Not surprisingly, the AG fails to address MWD's statutory right to seek modification of an order pursuant to KRS 278.390, which gives the Commission continuing jurisdiction to review and modify its orders:

> ... Every order entered by the commission shall continue in force until the expiration of the time, if any, named by the commission in the order, or until revoked **or modified** by the commission, unless the order is suspended, or vacated in whole or in part, by order or decree of a court of competent jurisdiction. (Emphasis added).

The AG's argues that *res judicata* precludes the modification of the order in Case No. 2014-00342 because of the denial of a request for rehearing and the failure of MWD to appeal that order. That argument makes KRS 278.390 granting the power to modify orders meaningless. This statute recognizes that circumstances change, which may necessitate a modification of a prior order. There is no limitation on this power, except when a court order has been issued and none has been in this case. Jurisdiction of the PSC to modify an order is not predicated on or limited by a rehearing decision or failure to appeal.

MWD has filed a petition seeking a modification pursuant to KRS 278.390. The reason for the petition is the action by the board of commissioners of MWD to terminate the contract with Utility Management Group (UMG). This change of circumstances provides the opportunity to modify the prior order to reflect the current status of the management of the district.

KRS 74.070 gives the district's board of commissioner's power to manage the district:

> **74.070 Duties and powers of commission -- Corporate powers of water district exercised by or under authority of commission.**
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> (1) The commission shall be a body corporate for all purposes, and may make contracts for the water district with municipalities and other persons.
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> (2) All corporate powers of the water district shall be exercised by, or under the authority of, its commission. The business and affairs of the water district shall be managed under the direction and oversight of its commission.

In contrast to this exclusive authority to manage the district, the Public Service Commission has no authority over the district's management decisions. The PSC's limited jurisdiction over the Board's actions is clearly defined by statute. KRS 278.015 gives the Commission jurisdiction over the rates and service of MWD. To the extent that the decision to self-manage affects service or rates, the PSC clearly has jurisdiction. But the decision about the type of management is for the MWD board. Management decisions are presumed to be reasonable. Pa Pub. Util. Comm'n v. Phila. Elec. Co., 561 A.2d 1224; West Ohio Gas Co. v. Ohio Pub. Util. Comm'n, 294 U.S. 63 (1935) cited in "Newport City of Newport v. Campbell County Kentucky Water District and Kenton County Water District No. 1 and Charles Atkins and Steven J. Franzen v. Campbell County Kentucky Water District." Case Nos. 89-014, 89-029 and 89-179, January 31, 1990.

The PSC recognized in that case the jurisdictional distinction of management and rate issues:

> The Commission's powers are purely statutory. "(L)ike other administrative agencies, it has only such powers as are conferred expressly or by implication." Croke v. Public Serv. Comm'n, 573 S.W.2d 927, 929 (Ky. App. 1978). Additional powers cannot be conferred on an administrative agency by contract of the parties. Borough of Glen Rock v. Village of Ridgewood, 135 A.2d 506 (N.J. 1957). . .
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> The Commission also lacks the power to order Campbell District to enter into negotiations with Newport for a long-term water supply contract. Such action amounts to the Commission's selection of Campbell District's water supplier which is clearly a management decision. A regulatory commission lacks the power to make such decisions. The United States Supreme Court has noted that:
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> > [W]hile the state may regulate, with the power to enforce reasonable rates and services, it is not the owner of the property of public utility companies, and is not clothed with general power of management incident to ownership. Missouri v. Southwestern Bell Tele. Co., 262 U.S. 276, 289 (1923).
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> The power to fix and regulate utility rates "does not carry with it, either explicitly or by necessary implication, the power to make management decisions." Union Carbide Coro. v. Pub. Serv. Comm'n, 428 N.W.2d 322, 328 (Mich. 1988). . . (Newport, *supra,* p. 19)

The AG assumes that by forcing MWD to engage in the RFP process, it can dictate or at least influence the decision of the MWD board, which will avoid what he considers an uninformed decision. However, that position is not supported by any regulatory law. The legal standard is explained in Union Carbide Corporation, 428 N.W.2d 322, 328 cited above in the Commission's Newport, *supra*, decision:

> ... [T]he commission argues that its authority to fix and regulate reasonable utility rates, of necessity, **encompasses the power to prevent noneconomic management practices, which threaten the integrity of the ratemaking process**. As this Court asserted in Detroit v. Public Service Comm., 308 Mich. 706, 716, 14 N.W.2d 784 (1944), "[i]t is the duty of the commission, under its statutory power, to fix a just and reasonable rate." ...**The commission's**

> **argument, though it may be economically supportable, is legally unsound.** The commission is a creature of the Legislature and, as such, possesses only those powers conferred upon it by statute. See G & A Truck Line, supra, 337 Mich. at 305, 60 N.W.2d 285; Kirkby, supra, 320 Mich. at 612, 32 N.W.2d 1; Sparta Foundry, supra, 275 Mich. at 564, 267 N.W. 736. The power to fix and regulate rates, however, does not carry with it, either explicitly or by necessary implication, the power to make management decisions. (Emphasis added).

The flaw in the argument of the AG is that even if the RFP is issued and a recommendation made by an independent consultant, that recommendation has no legally binding effect on the MWD commissioners. The AG cannot force the MWD management to accept any bid for services as the Newport case, *supra*, confirms. Having made the decision to regain control of the day to day operations, it is highly unlikely that the board will reverse its position and operate under a contract for management. It would appear that the purpose of the original PSC order was to prevent an automatic renewal of the UMG contract. The Board's decision to terminate the contract accomplished that goal. The District has agreed that if it ever elects to contract out management services again, it will abide by the terms of the PSC's order to use an independent consultant.

The AG asserts that MWD could have accumulated savings if it had terminated the UMG contract years ago, yet his current pleading mandates the opportunity for UMG to bid on a new contract under a structure the AG claims is the source of that economic loss. The January 20, 2016 action of the MWD board precludes that possibility.

The AG's motion refers to the "least cost" option for management, but cost is only one factor in the determination of the appropriate management form. Daily oversight, timing of decisions, employee selection and qualifications, prioritizing of maintenance and capital projects are all important factors to consider in the evaluation of self-management. As MWD has discovered over the course of the UMG contract, it is not simply cost, but control that determines the quality and economics of service. While the UMG

contract may have started out as a lower cost option in 2005, it quickly grew into the higher cost option. Such is the nature of these contracts.

MWD's request for the modification of the prior order recognizes these facts. It also recognizes that the cost of the RFP and the delay in the cancellation of the UMG contract will cost MWD customers as much as $320,000. It would seem that if the AG is truly concerned about the financial impact of the operations of MWD on its customers, it would support the decision to terminate the UMG contract as quickly as possible and also avoid the cost of the RFP. At some point the money for these costly actions will have to be borne by the customers – presumably the group represented by the AG, although his efforts seem more beneficial to UMG than the customers by giving UMG the opportunity to participate in a new RFP process. A process that if upheld will be the direct result of the AG's action in this matter.

The other argument of the AG asserts *res judicata* bars the adjudication of issues that have already been litigated or should have been litigated in a prior case between the same or similar parties. Kentucky courts have held that *res judicata* applies to quasi-judicial acts of "public executives, or administrative officers and boards acting within their jurisdiction," **unless there has been a significant change of conditions or circumstances that has occurred between two successive administrative hearings.** Williamson v. Public Service Commission Ky., 174 S.W.2d 526, 529 (1943); Bank of Shelbyville v. Peoples Bank of Bagdad Ky., 551 S.W.2d 234, 236 (1977). (Emphasis added).

. The AG admits that *res judicata* cannot apply to this case by acknowledging that there is a difference between this case and the prior one (AG Motion, p. 4). He claims it is a minor difference, but in fact it is a significant difference. On January 20, 2016, the MWD board of commissioners voted to terminate the UMG contract. At the time of the prior hearing, the UMG contract was in effect and was not subject to

termination during the course of the case. Subsequent to the issuance of the final order, the rehearing order and the expiration of the appeal period, the contract became terminable. Had the contract been terminated during the course of the prior case, the PSC's decision may have been different. Yet, because of the timing of the case and the terms of the contract, that issue was not litigated and the parties had no opportunity to litigate it. It certainly was not a factor in the PSC's decision to mandate the RFP.

So, in spite of the AG's characterization of the contract termination as minor, it is in fact a significant change to the facts of the prior case and an issue that was not factored into the final order of that case. Now that the MWD board has acted, the PSC is faced with a fact not in existence during the former proceeding. As such, *res judicata* does not prevent a review of the prior decision, nor does it prevent the Commission from modifying an order that remains subject to its jurisdiction based on a change of facts.

Recognizing the weakness of his position, the AG offers an alternative to the RFP, which is an independent consultant to oversee the transition to self-management. The need for or benefit of this oversight are not explained by the AG, nor is the source of funds to pay for the cost – other than in rates paid by the AG's presumed clients – MWD ratepayers, which is another unnecessary expense the AG seems willing to impose on his constituents.

MWD currently has a full time district administrator and a full time financial officer. It has a long-time independent CPA and local counsel. With one exception, the entire MWD management team that UMG initially employed in 2005 is still working for UMG on MWD operations. The transition to self-management should involve only the re-hiring of field and administrative staff, most of whom will more likely than not be terminated by UMG at the end of the contract. There may be a need for a part time Human Resources specialist to establish the initial payroll, retirement and benefits system. Given the experience of the current district administrator and

financial officer and the re-employment of staff employees familiar with the operations of the district, there should be only minor transition issues associated with the move to self-management.

The crux of the AG's motion is that MWD should spend $90,000 of ratepayer money for an unenforceable RFP that will merely confirm its decision to save approximately $462,000 annually on the UMG contract. Yet, while the AG's RFP process is pending, MWD will be forced to continue to spend $38,500 a month to pay UMG for services the board has already determined to be over priced and inadequate. The only beneficiaries of this unjustified cost to MWD's customers are the consultants and the management of UMG, who will receive a financial windfall at the expense of higher rates to be paid by MWD customers.

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Certificate:

I certify that a copy of this reply was mailed to the Attorney General's Office of Rate Intervention on the 15 day of February, 2016.