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COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF SANDY HOOK WATER)	
DISTRICT FOR RATE ADJUSTMENT)	CASE NO. 2016-00265
PURSUANT TO 807 KAR 5:076)	

ATTORNEY GENERAL'S COMMENTS

Comes now the intervenor, the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention, and pursuant to the Commission's October 17, 2016, Order tenders the following comments in the above-styled matter. The comments filed herein, along with any exhibits tendered for filing to the public record of this matter, represent the preliminary position of the Attorney General. The Attorney General reserves his right as an intervenor in this proceeding to fully participate in a hearing or informal conference that may be scheduled, and to file a post-hearing brief, if desired and consistent with the Commission's Scheduling Order.

I. STATEMENT OF THE CASE

Sandy Hook Water District ("Sandy Hook") is a water district organized pursuant to KRS Chapter 74 which serves 1,234 customers in Morgan and Elliott Counties.¹ On July 19, 2016, Sandy Hook tendered an application with the Public Service Commission of Kentucky ("the Commission") requesting a revenue increase of 25.56 percent, which would produce an increase of \$161,442.00.² According to Sandy Hook, the proposed increase would cause an average

¹ *Application of Sandy Hook Water District for Rate Adjustment Pursuant to 807 KAR 5:076*, Case No. 2016-00265 (Ky. PSC July 19, 2016) (hereinafter "Application"); ARF Form-1 July 2014, at 2-3.

² Application, ARF Form-1 – Attachment RR-DC September 2011, Revenue Requirement Calculation – Debt Coverage Method.

residential customer's bill to increase from \$42.80 to \$52.80, or 23.36 percent.³ The application uses Sandy Hook's annual report for the 12 months ending December 31, 2015, with necessary adjustments, to determine the reasonableness of Sandy Hook's proposed rates.⁴ According to the application, Sandy Hook is operating at a deficit and requires the proposed increase to properly maintain and operate its system, as well as meet all obligations.⁵

Commission Staff performed a limited financial review of Sandy Hook's test-year operations, which determined only whether operations reported for the test year were representative of normal operations.⁶ Based on this review, Staff determined that Sandy Hook's adjusted test-year operations would support a revenue increase of \$165,363, or 26.82 percent.⁷ Since Sandy Hook performed no cost-of-service study, Staff applied an across-the-board rate increase of 26.82 percent to generate the additional revenue, which increased the average residential customer's bill by \$11.48 rather than Sandy Hook's requested \$10.00.⁸ Despite the Staff Report's recommendation of a higher rate, Sandy Hook filed its response on November 22, 2016 and elected not to request the higher rate increase and instead reiterated its request for an increase of 25.56 percent.⁹

The Attorney General, by and through his Office of Rate Intervention, sought and was granted intervention by Order of the Commission on August 3, 2016.¹⁰ Although supportive of Sandy Hook's decision not to burden its ratepayers with Commission Staff's recommended

³ Application, Customer Notice, at 1.

⁴ Application, ARF Form-1 July 2014, at 3.

⁵ Application, ARF Form-1 Attachment SR September 2011, Reasons for Application.

⁶ Case No. 2016-00265, Commission's Staff Report on Sandy Hook Water District (November 15, 2016), at 2. (hereinafter, "Staff Report")

⁷ *Id.* at 3.

⁸ *Id.*

⁹ Case No. 2016-00265, Sandy Hook Water District Notice of Acceptance and Waiving of Hearing (November 22, 2016). (hereinafter, "Sandy Hook Response")

¹⁰ Case No. 2016-00265, Order (August 3, 2016).

increase to proposed rates, the Attorney General wishes to highlight areas of concern which could lead to rates which are unfair, unjust, and unreasonable.¹¹

II. COMMENTS

Sandy Hook bears the burden of proof to show “that the rates contained in its application were just and reasonable.”¹² Although the Attorney General supports Sandy Hook’s decision not to burden ratepayers with the higher rate recommended by Commission Staff, the record does not demonstrate the reasonableness of certain expenses. Additionally, even if the Commission determines all expenses to be reasonable, the length of time between rate cases has led to the need for a steep rate increase rather than a gradual increase with a less harmful impact on ratepayers.

A. Compensation

Sandy Hook reported \$205,626 spent on employee wages during the test-year with five full-time employees and two part-time employees.¹³ Staff adjusted employee wages to reflect that one full-time maintenance employee had been laid off in September of the test year with no immediate plans for replacement.¹⁴ Since 2011, Sandy Hook has increased the number of employees from four to seven, with the current number of employees being six.¹⁵ Employee wage expenses have risen accordingly, from \$113,703.14 in 2011 to their current levels.¹⁶ Sandy Hook appears to have a policy of annual raises of up to 5 percent unless Sandy Hook has financial

¹¹ 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).

¹² *Kentucky-American Water Company v. Commonwealth ex rel. Cowan*, Ky., 847 S.W.2d 737, (1993).

¹³ Staff Report, at 6.

¹⁴ *Id.*

¹⁵ Sandy Hook’s Response to AG-2(a)(i-ii).

¹⁶ *Id.*

difficulties or an employee demonstrates poor performance.¹⁷ Employees received raises under that policy in both 2014 and 2015, despite Sandy Hook's statement that it currently operates at a deficit.¹⁸ The record contains no justification for this policy or the current staffing levels, but Sandy Hook has requested to recover the expenses in rates.¹⁹

With rising utility bills, the Commission has recognized a need for increased scrutiny on compensation and benefits.²⁰ As a result, emphasis has been placed on the competitiveness of salary and benefits in the broader regional market in which an utility operates.²¹ The Attorney General urges the Commission to consider the reasonableness of Sandy Hook's salary and benefits in relation to local wages and benefits in non-utility industries operating in Morgan and Elliott Counties.

B. Operational Expenses

The Attorney General has identified several large expenditures which, after reviewing the record, he is not able to assert are reasonable. First, Sandy Hook included in its application \$132,520.97 categorized as "Miscellaneous Expense."²² In discovery, the Attorney General asked Sandy Hook to provide a breakdown of this category. Sandy Hook provided a list of subcategories and costs, including \$88,113.57 classified as "System Maintenance and Repair."²³ The response did not include to whom this amount has been paid, whether a contract for services exists, or whether a competitive bid was ever issued for those services. This information is similarly

¹⁷ Sandy Hook's Response to AG-2(a)(iii), at Meeting Minutes for April 9, 2015.

¹⁸ Sandy Hook's Response to AG-2(a)(iii), at Meeting Minutes for February 13, 2014 and June 11, 2015.

¹⁹ See, 807 KAR 5:076(3), the record upon which a decision shall be made.

²⁰ Case No. 2015-00312, *In the Matter of: Application of Kenergy Corp. for a General Adjustment in Rates*, Order, at 15 (Ky. PSC September 15, 2016).

²¹ *Id.*

²² Application, ARF Form-1 Attachment AO-W September 2011, Schedule of Adjusted Operations. Staff adjusted the "Miscellaneous Expense" category to a Pro Forma \$132,273.00. See, Staff Report, at 4.

²³ Sandy Hook's Response to AG 1-2(e).

unavailable in Sandy Hook's annual reports, application, the Staff Report, or other discovery responses. Without further justification, the Attorney General believes the inclusion of \$88,113.57 in the test year expenses to be unreasonable.

Second, for the 2015 test year, Sandy Hook provided invoices for \$10,500 paid to accounting firm Morgan-Franklin, LLC for an audit covering financial year 2014.²⁴ However, invoices for 2014 show \$18,500 paid to Morgan-Franklin, LLC for accounting services, including \$12,500 for an audit covering financial year 2013.²⁵ No information in the record explains this discrepancy or reflects whether Morgan-Franklin, LLC was retained following a competitive bid process. Although the record contains a letter setting out the terms of the business relationship between Sandy Hook and Morgan-Franklin, LLC, it covers only the 2013 audit.²⁶ No similar memorandum is included concerning the 2014 audit. As a result, there is no way to determine why the price of the audit was lowered from one year to the next, or to predict what the price of the next audit might be. In the absence of a contract demonstrating the cost of the audit and the scope of the work performed, the Attorney General believes inclusion of this cost in the test year expenses to be unreasonable due to the lack of bid or other justification for the cost.

The Attorney General believes that, absent any justification in the record, Sandy Hook has failed to meet its burden. The Attorney General urges the Commission to examine whether the accounting and "System Maintenance and Repair" expenses are reasonable before using them for ratemaking purposes. If these contracts have never been submitted for a competitive bid, the

²⁴ Sandy Hook's Response to AG 1-4.

²⁵ *Id.*

²⁶ *Id.*

Attorney General would support issuance of bids to determine whether the reasonableness of the current expenses.

C. Rate Design and Impact

The Attorney General supports Sandy Hook's decision not to request the higher rate proposed by Staff. Despite Sandy Hook's decision to request the initial rate proposed in its application, the Attorney General remains concerned at the impact such a steep rate increase will have on Sandy Hook's customers.

Prior to filing its application on June 19, 2016, Sandy Hook's last general rate case had been filed on June 17, 2005.²⁷ In that case, the Commission approved a 19.5 percent increase in revenue, resulting in a 27.6 percent increase to the average residential customer's bill.²⁸ Commission Staff has previously stated that a utility's service rates have a life of five years, "since rates tend to become obsolete due to changes that will likely occur to the utility's cost of service in a five-year period."²⁹ Despite this, Sandy Hook did not update its rates until 2013, when instead of filing an application for another rate case, Sandy Hook filed an application for a Certificate of Public Convenience and Necessity pursuant to KRS 278.023.³⁰ To finance the proposed construction, Sandy Hook was awarded loans from the United States Department of Agriculture, Rural Development.³¹ The application included a new rate schedule which would increase revenue to meet the debt service requirements of the new financing.³² The Commission approved the rate

²⁷ Case No. 2005-00233, *The Application of the Sandy Hook Water District for the Approval of a Proposed Increase in Rates for Water Service* (Ky. PSC June 17, 2005).

²⁸ *Id.*, Order (Ky. PSC October 19, 2005).

²⁹ Case No. 2016-00054, *Application of Caldwell County Water District for Rate Adjustment Pursuant to 807 KAR 5:076*, Staff Report (Ky. PSC May 4, 2016).

³⁰ Case No. 2013-00379, *Application of Sandy Hook Water District for a Certificate of Public Convenience and Necessity to Construct, Finance and Increase Rates Pursuant to KRS 278.023* (Ky. PSC October 25, 2013).

³¹ *Id.*

³² *Id.*

increase as laid out in the application with no further inquiry due to the constraints of KRS 278.023, which requires the Commission to approve federally-funded construction projects.³³

Although Sandy Hook has increased rates since the 2005 rate case, the increase did not address Commission Staff's stated concern about changes to cost of service which are likely to occur over five-year periods. The increase approved in 2013 covered new debt service requirements, but there is no evidence in that record to suggest that it also addressed changes to cost of service.³⁴ As a result of the over ten year delay between rate cases, Sandy Hook has requested an increase in revenue which will result in a 25.56 percent increase to the average residential customer's bill.³⁵ The principle of Gradualism provides that ratepayers are more able to absorb an increase in fixed rates or fees over a period of time, rather than a large, acute increase in rates. Exercising this principle helps the Commission to protect the financial integrity of the ratepayers. The Commission has acknowledged its long history employing the principle of Gradualism in rate making in order to mitigate the financial impact of rate increases on customers.³⁶ Although a subjective determination, a 25.56 percent increase to average residential bills is a significant and acute increase that is likely to harm customers and could have been avoided if Sandy Hook had requested a reasonable increase in timely manner. The Attorney

³³ *Id.*, Order (Ky. PSC November 14, 2013); *Id.*, Order (Ky. PSC November 26, 2013).

³⁴ *Id.*

³⁵ Staff Report, at 1.

³⁶ Case No. 2014-00396, *In the Matter of Application of Kentucky Power Company for: (1) A General Adjustment of its Rates for Electric Service; (2) An Order Approving its 2014 Environmental Compliance Plan; (2) An Order Approving its Tariffs and Riders; and (4) An Order Granting All Other Required Approvals and Relief*, Order (Ky. PSC June 22, 2014) ("...the Commission has long employed the principle of gradualism...."); *See also*, Case No. 2000-080, *In the Matter of: The Application of Louisville Gas & Electric Company to Adjust its Gas Rates and to Increase its Charges for Disconnecting Service, Reconnecting Service and Returned Checks*, Order (Ky. PSC September 27, 2000) ("... the Commission is adhering to the rate-making concepts of continuity and gradualism in order to lessen the impact of these increases on the customers that incur these charges.").

General urges the Commission to consider the effect that such a steep increase will have on Sandy Hook's customers.

Additionally, if the Commission finds that a rate increase is reasonable, in the absence of a cost-of-service study, the Attorney General agrees with Commission Staff that any increase in rates should be applied evenly across the board.³⁷ In the event that the Commission grants Sandy Hook's requested revenue increase, the Commission should apply the increase across the board following the method used in the Staff Report.³⁸

III. CONCLUSION

WHEREFORE, based on the factual record and reasons set forth in comments, the Attorney General asserts that the rates requested by Sandy Hook are not fair, just, and reasonable. Absent justification in the record for the expenses discussed above, Sandy Hook has failed to meet the required burden of proof. Although the Attorney General supports Sandy Hook's decision not to seek the higher rate recommended by Commission Staff, the requested rate still violates the long held principles of gradualism. For these reasons, the Attorney General cannot support the requested revenue increase.

³⁷ Staff Report, at 3.

³⁸ *Id.*

Respectfully submitted,

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Certificate of Service and Filing

Counsel certifies that an original and ten photocopies of the foregoing were served and filed by hand delivery to Talina Mathews, Acting Executive Directors, Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601; counsel further states that true and accurate copies of the foregoing were mailed via First Class U.S. Mail to:

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this 29th day of November 2016.

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