



# Kentucky Rural Water Association

Helping water and wastewater utilities help themselves

February 6, 2018

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FEB 09 2018

PUBLIC SERVICE  
COMMISSION

Ms. Gwen R. Pinson, Executive Director  
Public Service Commission  
P. O. Box 615  
Frankfort, KY 40602-0615

Case No. 2018-00063

Dear Ms. Pinson:

Kentucky Rural Water Association (KRWA) has scheduled a training session for Oldham County Water District for February 13, 2018. This session will be held at the Oldham Co. Water District office in LaGrange, Kentucky, and will offer a maximum of 6 hours of continuing education credit for water district commissioners.

An original and ten copies of the agenda are enclosed. The agenda includes a description of the topics and a brief biography for the speakers. We are including one copy of the PowerPoints that have been submitted by the two speakers. This class has not been submitted to any other organization for approval of continuing education credit.

With this letter and enclosures Kentucky Rural Water Association respectfully requests that this training be approved for continuing education credit for commissioners as referenced in regulation 807 KAR 5:070. If additional information is needed, please do not hesitate to contact our office.

Sincerely,

  
Janet Cole  
Education Coordinator  
j.cole@krwa.org

Enclosures  
(Original and 10 packets)

**CONTINUING EDUCATION TRAINING  
FOR OLDHAM CO. WATER DISTRICT COMMISSIONERS**



2160 Spencer Court  
LaGrange, Kentucky

Presented by

**Kentucky Rural Water Association**

February 13, 2018

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PUBLIC SERVICE  
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- 10:00 a.m. – 10:10 a.m.    **Registration**
- 10:10 a.m. – 10:15 a.m.    **Welcome and Program Overview**  
**Gary Larimore, Kentucky Rural Water Association**  
**Russ Rose, Oldham Co Water District**
- 10:15 a.m. – 11:15 a.m.  
(1 hour)    **Session 1: Utility Litigation Update**  
**Damon Talley, Stoll Keenon Ogden**  
This presentation reviews recent court decisions involving public and municipal utilities and discusses courses of action to mitigate the decisions' impact on utilities. Topics include franchises, wholesale water purchase agreements, obtaining PSC Approval before borrowing money, and unaccounted water loss. Special emphasis will be given to recent decisions affecting water utilities.
- 11:15 a.m. – 11:20 a.m.    **BREAK**
- 11:20 a.m. – 12:20 p.m.  
(1 hour)    **Session 2: Recent Developments in Utility Regulation, Part I**  
**Gerald Wuetcher, Stoll Keenon Ogden**  
This presentation reviews recent developments in public utility law and regulation. Presenter will identify and discuss significant PSC decisions in the last year, including decisions regarding depreciation and employee compensation, as well as possible strategies to assist the PSC in its review of utility applications in this era of increasing budgetary and personnel constraints.
- 12:20 p.m. – 1:00 p.m.    **Lunch (provided onsite)**
- 1:00 p.m. – 2:00 p.m.  
(1 hour)    **Session 3: Recent Developments in Utility Regulation, Part II**  
**Damon Talley and Gerald Wuetcher, Stoll Keenon Ogden**  
Special emphasis will be given to practical applications of the legal issues discussed in the morning presentation and whether recent PSC decisions on depreciation and employee compensation will impact municipal wholesale rates. The presenters will discuss pitfalls to avoid when dealing with the PSC and provide useful tips for expediting PSC case review.
- 2:00 p.m. – 2:15 p.m.    **BREAK**

- 2:15 p.m. – 3:45 p.m.  
(1.5 hours)      **Session 4: Duties and Responsibilities of Board Members**  
**Damon Talley, Stoll Keenon Ogden**  
This presentation reviews the Board's oversight role including other duties and responsibilities of Board members. In addition, conduct of Board meetings, open meetings, open records, and other relevant topics will be discussed.
- 3:45 p.m. – 4:00 p.m.      **BREAK**
- 4:00 p.m. – 5:30 p.m.  
(1.5 hours)      **Session 5: Ethics: A Practical Exercise**  
**Gerald Wuetcher & Damon Talley, Stoll Keenon Ogden**  
A review of ethics laws and principles that affect water utility policy makers and managers through the use of diverse and commonly recurring fact situations will be covered in this session. The presenters will emphasize fiduciary responsibilities of Board members and avoiding conflicts of interest.
- 5:30 p.m. – 5:45 p.m.      **Q and A Session**
- 5:45 p.m. – 5:50 p.m.      **Closing Remarks and Administrative Announcements**  
**Gary Larimore, Kentucky Rural Water Association**  
**Russ Rose, Oldham Co Water District**

## **SPEAKER BIOS**

**Damon R. Talley** is a member of the Utility & Energy practice at Stoll Keenon Ogden, focusing on water and wastewater utility law. His career includes representing water districts, water associations, water commissions, municipalities, privately owned utilities and numerous other utility clients. Damon aided in the development of the Kentucky Rural Water Association and has served as its general counsel since 1979. Additionally, he served as KRWA's representative on the Kentucky Infrastructure Authority Board from 2000 to 2015. Damon is a frequent speaker at training sessions sponsored by the KRWA, Public Service Commission, Division of Water, Utility Leadership Institute, Utility Management Institute and other industry groups.

**Gerald Wuetcher** is a member of Stoll Keenon Ogden's Utility & Energy practice. He spent more than 26 years at the Kentucky Public Commission, serving as a staff attorney, deputy general counsel and executive advisor. Although he worked on matters involving electric, natural gas, water and sewer utility issues, he is known for his experience in water and wastewater issues. Jerry developed the PSC's training program for water utility officials in 1998 and served as one of its principal instructors during his tenure at the PSC. After 27 years of service as a judge advocate in the U.S. Army, Jerry retired with the rank of colonel. He is a regular presenter at seminars on utility law and regulation.

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FEB 09 2018

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**Session 1: Utility Litigation Update**  
**Damon Talley, Stoll Keenon Ogden**

OLDHAM COUNTY  
**water** DISTRICT

**Utility Litigation  
Update**

February 13, 2018

*Rural Water*



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**Utility Litigation  
Update**

Damon R. Talley, General Counsel  
Kentucky Rural Water Association, Inc.  
Stoll Keenon Ogden PLLC  
damon.talley@skofirm.com  
270-358-3187



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**DISCUSSION TOPICS**

1. E-mail Address
2. Franchises & Contracts
3. Prevailing Wages
4. Pension Expense
5. Borrowing Money

Continued . . . 

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## DISCUSSION TOPICS

- 6. Cases to Watch
- 7. Skeletons in the Closet
- 8. 911 Funding Update
- 9. GASB 68 & NPL  
PSC Rate Making



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### E-Mail Address Regs.

- All PSC Orders Served by E-mail
- Duty to Keep Correct E-mail Address on file with PSC
  - Default Regulatory E-mail Address
- Duty to List E-mail Address in Application & All Other Papers
  - Utility Official
  - Its Attorney



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PSC Case No. 2016 - 310

Opened: 9 - 9 - 2016

Utility: Unlucky WD

Type: Show Cause Case

Issue: Ignored PSC Order &  
Wrong E-mail Address

Settled: \$500 Fine



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### E-Mail Address

- Who Is Covered?
  - Water Districts
  - Water Associations
  - Investor Owned Utilities
  - **Municipal Utilities**



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### Why Municipals?

- Contract Filing
- Tariff Change (Wholesale Rate)
- Protest Supplier's Rate Increase
- Acquiring Assets of Another Utility
- Avoid Delays



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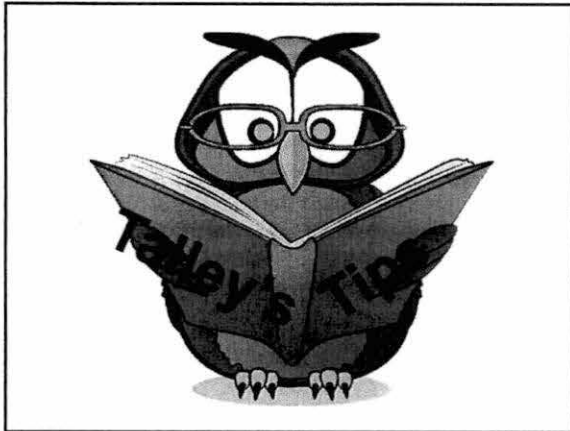
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### Default Regulatory E-mail Address

- Send E-mail to PSC
  - [psc.reports@ky.gov](mailto:psc.reports@ky.gov)
- Send Letter to PSC
  - Ms. Gwen R. Pinson  
Executive Director



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# Franchises and Contracts

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## Franchise

- Definition
  - Private
    - Rights granted by company to individual or business to sell a product
    - Examples

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## Franchise

### ▪ Definition

#### ➤ Government

- Privilege granted by government to utility to provide specific utility service
- Permission to erect facilities over & under streets, alleys, & sidewalks
- Fee: 3%
- Examples

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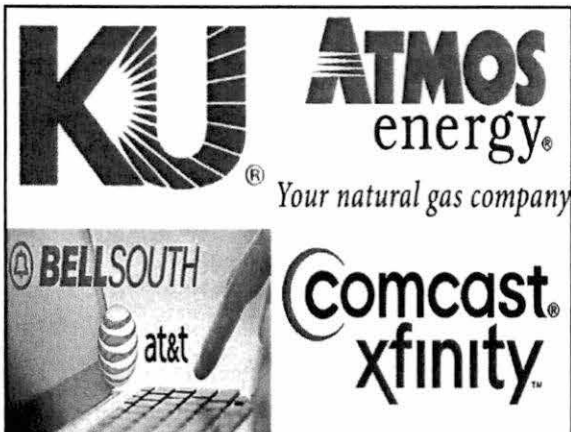
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## Livingston County Case

Ledbetter W.D.

vs.

Crittenden-Livingston WD

Circuit Court

Case No. 2015-CI-00079

Opinion Rendered: 1-25-17

Status: On Appeal

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Franchise Case - Holding  
**40-year**  
Water Supply Contract  
Between 2 Water Districts  
**Invalid**

- Why? Contract = Franchise
- Over 20 Years
- Basis: Kentucky Constitution Section 164



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**Franchise Case**

Crittenden - Livingston WD  
vs.

Ledbetter WD

Court of Appeals

Case No. 2017-CA-000578

Briefs Filed: 7-31-17 & 9-21-17

Amicus Brief: 8-11-17

Status: Pending



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### **Ky. Constitution Section 164**

No county, city, town, taxing district or other municipality shall be authorized or permitted to grant any franchise or privilege, or make any contract in reference thereto, for a term exceeding **twenty years**. Before granting such franchise or privilege for a term of years, such municipality shall first, after due advertisement, receive bids therefor publicly, and award the same to the highest and best bidder; but it shall have the right to reject any or all bids.



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### **Why?**

- 340 Water Utilities
- 169 WTPs
- 50% Buy Water
- Need Water Supply Contract
- Long Term

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### **How Long Is Long Term?**

- Lender
  - RD: 40 years
  - KIA: 20 or 30 years
  - Bonds: Length of Bonds



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### Significance

- If Franchise . . . 20 Year Limit
  - Can't Borrow \$ from RD
  - Other Sources – Only if < 20 years
    - KIA
    - Bonds
    - KRWFC



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### Legal Analysis

- Does Water District Have Franchising Authority?
  - Constitution: **NO**
  - Judge: **YES**
  - Damon: **NO**



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### Circuit Judge's Rationale

- Sovereign Power . . . Franchise
- Water District is Sovereign Power
- Water District . . . Franchise
- Problem
  - Ignored Wording of Constitution



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### Legal Analysis

- Is Water Purchase Agreement a Franchise?
  - Constitution: Silent
  - Case Law: Silent
  - AG Opinion: Yes 1981
  - Judge Yes
  - Damon: No



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### Circuit Judge's Rationale

- "The court concludes that the Water Purchase Contract is in fact a franchise . . ."
- Conclusion
- No Explanation



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### KRWA's Role

- Filed Amicus Brief
  - "Friend" of Court
- Protect Validity of Contracts
- Protect Ability to Obtain \$



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### What's Next?

- All Briefs Filed
- Oral Arguments     ? ? ?
- C/A Decision         ? ? ?
- Ky. Supreme Court ? ? ?



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### Your Role

- Ruling Is Limited to Livingston County . . . for Now
- Don't Change Behavior . . . for Now
- Stay Tuned
- Alert KRWA



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**Prevailing  
Wages**

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**Prevailing  
Wages**

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## Prevailing Wages

- State PW Repealed
  - HB 3
  - When? 1-9-2017
- Federal PW
  - Davis - Bacon Act

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## Old Law

- State PW Triggered By:
  - Public Works Project
  - Public Authority and
  - Over \$250,000
- Funding Source Immaterial

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## Davis - Bacon Wages

- DB Triggered By:
  - Public Works Project
  - Public Authority and
  - **Funding Source**

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### Davis - Bacon Wages ?

Funding Source	Yes	No
Reserve Funds		✓
RD		✓
KIA (Under Review)	✓	
CDBG	✓	
ARC	✓	
EDA	✓	

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### Davis - Bacon Wages ?

Funding Source	Yes	No
Tax Exempt Bonds		✓
KRWFC		✓
KLC		✓
KACo		✓
Multiple Sources	?	?

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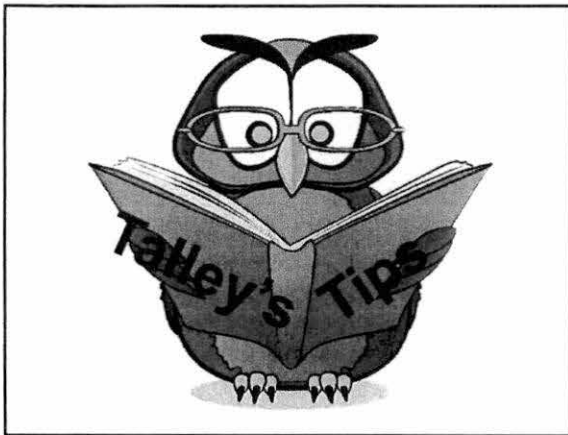
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### Davis - Bacon Wages

- Multiple Funding Sources
  - Does **Any** Funding Source Require DB Wages?
  - If Yes . . . Then Entire Project Requires DB Wages

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## Pension Expense

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### Pension Expense

- CERS
- Letter from State Budget Director
  - Revised Assumptions
  - Contribution Rate
    - FYE 6-30-18 19%
    - FYE 6-30-19 29%
- Actual Rates: December 2017

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### Pension Expense

- 67 of 112 Water Districts
- 60% of Water Districts
- Increase:
  - Total: \$3,912,147
  - Average: \$ 58,390
  - Median: \$ 32,183

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### Pension Expense

	Utility (Water Districts)	Increased Pension Expense	Gallons Sold (000)	\$ Per 1,000 Gallons
1	East Clark	\$ 23,681	110,000	\$ 0.22
2	Farmdale	\$ 12,857	151,113	0.09
3	Hardin # 2	\$ 307,326	2,102,525	0.15
4	Henderson	\$ 39,694	337,801	0.12
5	LaRue	\$ 32,619	162,477	0.20

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<b>Pension Expense</b>				
	<b>Utility (Water Districts)</b>	<b>Increased Pension Expense</b>	<b>Gallons Sold (000)</b>	<b>\$ Per 1,000 Gallons</b>
6	Montgomery	\$ 6,117	34,089	\$ 0.18
7	Northern Ky.	\$ 762,756	7,810,113	0.10
8	North Marshall	\$ 43,829	397,160	0.11
9	North Nelson	\$ 20,185	261,887	0.08
10	Ohio County	\$ 78,113	475,182	0.16

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<b>Pension Expense</b>				
	<b>Utility (Water Districts)</b>	<b>Increased Pension Expense</b>	<b>Gallons Sold (000)</b>	<b>\$ Per 1,000 Gallons</b>
11	Oldham Co.	\$ 82,578	1,286,711	\$ 0.06
12	So. Madison	\$ 32,462	263,225	0.12
13	Webster Co.	\$ 45,237	278,268	0.16
14				
15				

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<b>Options</b>	
<ul style="list-style-type: none"> <li>▪ Absorb</li> <li>▪ Pass Through to Customers</li> <li>▪ Rate Increase               <ul style="list-style-type: none"> <li>➢ PSC</li> <li>➢ City Council</li> </ul> </li> <li>▪ <b>Change Law</b></li> </ul>	

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**KRS 278.015**

**P**urchased

**W**ater

**A**djustment

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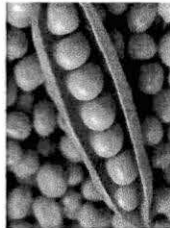
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**Law Change**

**P**ension

**E**xpense

**A**djustment



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**P E A**

- Base Year: 2017
- Increased Pension Expense
- Divide by Gallons Sold
- Per 1,000 Gallons Adjustment
- Line Item on Bill



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## Law Changes

- Your Thoughts
- Convince
  - KRWA Legislative Committee
  - KRWA Board
  - Legislators



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## Municipal Utilities

- Convince City Council
- Ordinance
  - Enact Once
  - Automatic **PEA** Annually



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**KRS 278.300(1)**

No utility shall issue any securities or evidences of indebtedness . . . until it has been authorized to do so by order of the Commission.

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**Practical Effect**

- Must Obtain PSC Approval Before Incurring Long-term Debt (Over 2 Years)
  
- Exception:
  - 2 Years or Less
  - 2 Renewals  
(3 X 2 = 6 Years)

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**Violation**

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# Show Cause Case

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## Method of Resolution

- Historically . . .
  - Acknowledge Mistake
  - Settle Out of Court . . . Very Quietly
  - Go to Training
  - Pay Small Fine
  - Stay Out of Trouble

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**Range of Outcomes**

- No Show Cause Case Opened
- \$100 Fine (Suspended)
- Go to PSC Training
- \$250 Fine (Suspended)
- More Training (Manager Also)

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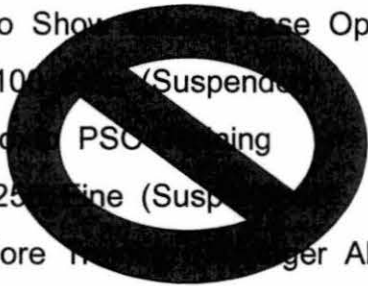
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**Range of Outcomes**

- No Show Cause Case Opened
- \$100 Fine (Suspended)
- Go to PSC Training
- \$250 Fine (Suspended)
- More Training (Manager Also)



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**Range of Outcomes (continued)**

- X** \$500 Fine (Sometimes Suspended)
- X** \$500 Fine & Much More Training
- No More Settlements
- Public Hearing & Then Fined (Suspended)



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**Who Is Affected?**

- Utility
- Current Commissioners
- Former Commissioners
- Manager
- Attorney
- Lender ???

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**Show Cause Case # 1**

Case No. 2016 - 338  
Opened: 10 - 11 - 2016  
Closed: 02 - 23 - 2017  
Issue: KRS 278.300  
Hearing: 12 - 13 - 2016

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**Timeline - Bond Refinancing**

05 - 13 - 2013 Board Adopts Resolution  
Borrow \$1,530,000  
12 - 17 - 2014 PSC Application Filed  
Borrow \$1,485,000  
01 - 05 - 2015 PSC Order Issued  
02 - 05 - 2015 KRWFC Bond Sale  
02 - 19 - 2015 Loan Closing  
Borrow \$2,780,000

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### Timeline

03 - 31 - 2015	Board Lawyer Filed Docs
12 - 28 - 2015	ARF Application Filed
04 - 15 - 2016	Staff Report Issued
10 - 11 - 2016	Show Cause Order
11 - 16 - 2016	Informal Conference
12 - 13 - 2016	<b>Formal Hearing</b>
02 - 23 - 2017	Order



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### Facts

Total Savings:	\$478,376
NPV Savings:	\$326,209
Amount Approved:	\$1,485,000 + 10%
Amount Borrowed:	\$2,780,000

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### Show Cause Case # 1

- Ruling:
  - \$500 Fine (Suspended)
  - Rejected Advice of Counsel Argument
  - Lawyer on Hook

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**Show Cause Case # 1**

- Process Is Noteworthy:
  - Begged to Settle
  - PSC Said No
- Formal Hearing

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**Show Cause Case # 2**

**PSC Case No. 2017-176**

Order: 8-18-2017  
Utility: Water District  
Type: ARF Case  
Holding: Hold Hearing  
Why? Violated 278.300



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**Show Cause Case # 2**

Staff Report: 8-9-2017  
Recommended: 24% Rates  
\$360,000 Annual  
\$30,000 per Month  
3 Loans - Local Bank  
Hearing: 11-1-17



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**Hearing on 11-1-17**

- Purposes:
  - Line Loss - 33%
  - Violation of 278.300
  - Purpose of Loans
  - Fringe Benefits



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**Hearing on 11-1-17**

- Who Must Attend?
  - Each Commissioner
  - Office Manager
  - Distribution System Manager



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**Talley's  
Take  
Aways**



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**PSC Commissioners:**

- Take Their Jobs Seriously
- Hands On
- Love Hearings
- Promote Transparency
- Oversight Means Oversight



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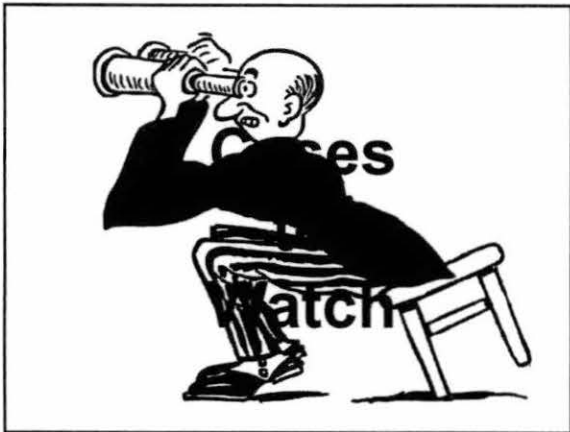
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**PSC Case No. 2016-432**

Filed: 12-29-2016  
Utility: Hardin Co. WD No. 2  
Type: Declaratory Order  
Issue: 15 Year Meters  
Sample Testing  
Decided: ? ? ? ? ?



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**PSC Case No. 2017-070**

Staff  
Report: 6-30-2017  
Utility: Monroe Co. WD  
Type: ARF  
Issue: Depreciation  
Fringe Benefits



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**PSC Case No. 2017-246**

Filed: 6-30-2017  
Utility: McCreary Co. WD  
Type: Deviation  
Issue: Daily Inspection of  
Grinder Pumps



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**PSC Case No. 2016-394**

Filed: 11-18-2016  
Utility: KAW  
Type: Deviation  
Issue: Annual Inspection of  
Meters & Valves  
Hearing: 10-31-2017



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**PSC Case No. 2016-427**

Filed: 12-08-2016  
Utility: Northern KY WD  
Type: Deviation  
Issue: Annual Inspection of  
Meters & Valves

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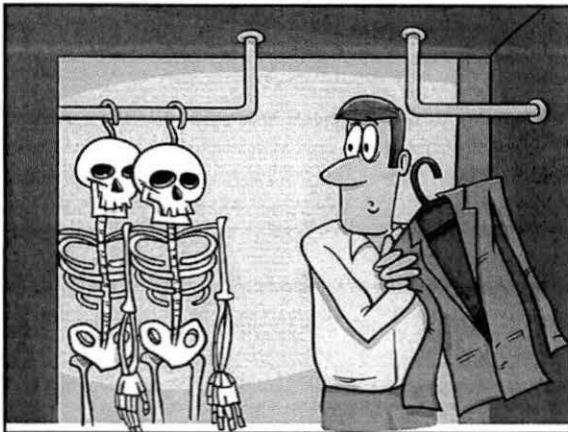
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**911  
Funding  
Update**

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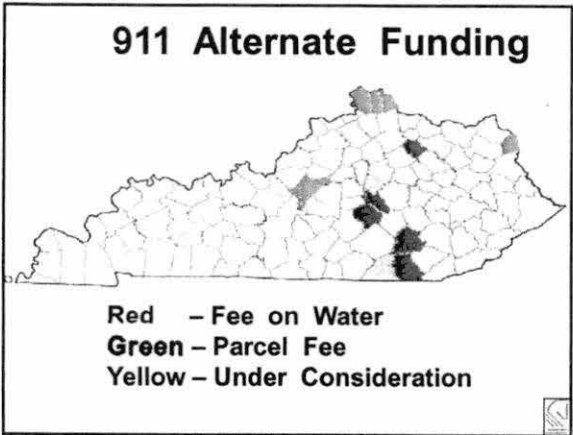
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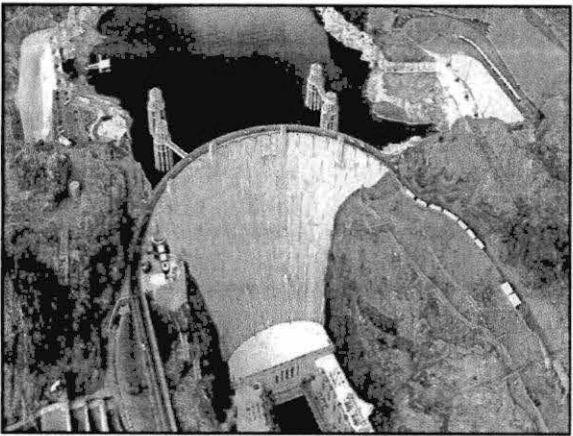
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**OK**  
To  
**Put 911 Fee**  
On  
**Water Meters**

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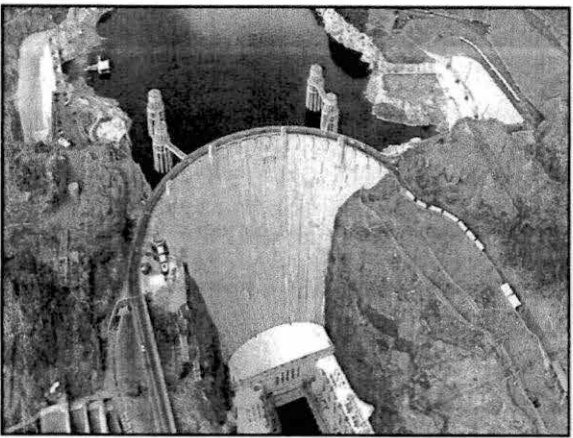
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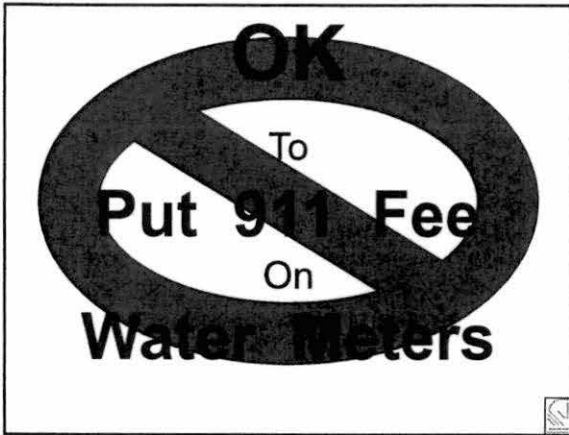
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**Garrard County Case**  
City of Lancaster, et al  
vs.  
Garrard County, Kentucky  
Court of Appeals  
Case No. 2013-CA-000716-MR  
Opinion Rendered: 7-03-14  
Opinion Vacated: 2-18-16  
New Opinion: 8-11-17

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**Campbell County Case**  
Greater Cincinnati / Northern Ky.  
Apartment Assoc., Inc., et al  
vs.  
Campbell Co. Fiscal Court, et al  
Supreme Court of Kentucky  
479 S.W.3d 603 (Ky. 2015)  
Opinion Rendered: 10-29-15  
Became Final: 02-18-16

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### Parcel Fee

- Occupied Residential & Commercial Properties
  - Campbell County (8-17-13)
    - Parcel Fee (Per Unit)
    - \$45.00 per Year
  - Kenton County
    - Per Parcel, Not Per Unit
    - \$60.00 per Year



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### Parcel Fee

- Campbell County Case
- Ky. SC Rules ... 10-29-15  
(Became Final: 2-18-16)
  - Parcel Fee OK
  - Not a "User" Fee
  - Not a "Tax"
  - "Service" Fee



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### Unresolved Legal Issues

- Does County Have Legal Authority to:
  - Compel City to Collect Fee?
  - Compel WD to Collect Fee?
  - Compel WA to Collect Fee?
  - Compel IOU to Collect Fee?



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## Unresolved Legal Issues

- Does County Have Legal Authority to:
  - Impose 911 Fee on:
    - City Utility?
    - Water District?
    - Water Association?
    - Investor Owned Utility?



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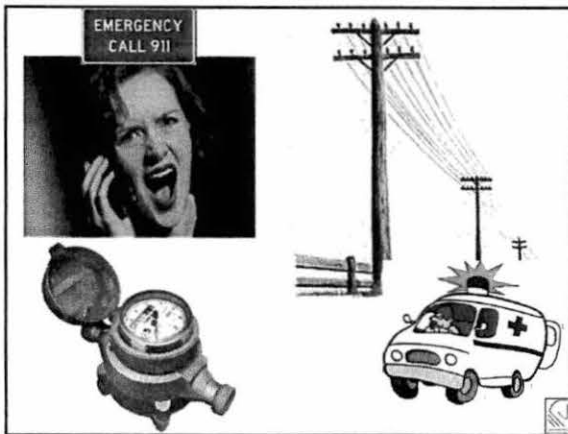
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## Current Status

- Campbell County – Parcel Fee OK
- Garrard Co. – Water Meter Fee OK
  - But **Wait!!!** Motion for Discretionary Review Filed
  - In Limbo



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### **Your Role**

- Prepare for PR Battle
- Stay Informed
- Be Vigilant
- Alert KRWA
- Don't Ignore the Problem



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### **If Stuck With A Fee**

- Collection Agreement with County
  - Tax Collector Not Tax Payer
  - Hold Harmless Clause
    - Refunds
    - Legal Fees
- Show As Line Item on Bill  
(If PSC Permits)



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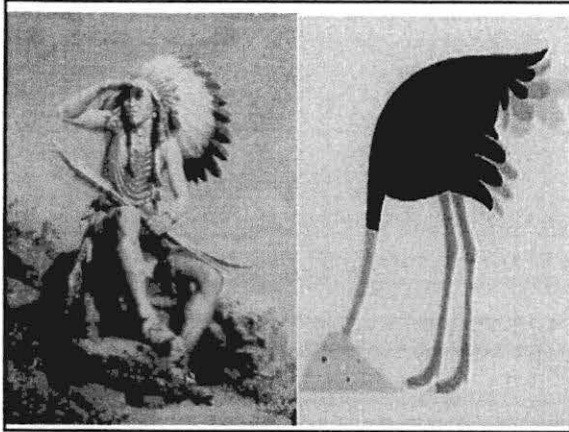
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# **GASB 68 & NPL PSC Rate Making**

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- Background GASB 68**
- CERS
    - Net Pension Liability
    - Utility's % of NPL
  - GASB 68
    - Adopted: 2012
    - Effective:
      - Cities FYE 6-30-15
      - WDs FYE 12-31-15

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### **Background GASB 68**

- Purpose
  - Financial Statements Reflect Potential Impact of Unfunded Pension Liability
  - Each CERS Employer Reports Its % of NPL
- Impact on Rate Making



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PSC Case No. 2016 – 163  
Issued: 8-11-16 (Staff Report)  
Utility: Marion Co. Water Dist.  
Type: ARF Case  
Issue: PSC Rate Making  
Treatment Under  
GASB 68 & NPL



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### **Staff Report**

- Thorough Analysis (21 pages)
- Cash Flow Needs
  - Utility's Cash Contribution to CERS
  - Ignores NPL for Rate Making
- Avoids Wide Fluctuations
- No Change – Revenue Requirements



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## Staff Report

- Balance Sheet Treatment
  - Complicated
  - Creates Regulatory Asset
    - Prevents "Big Hit"
    - Avoids Wild Fluctuations
- PSC Approved: 11-10-2016
- Adopted Staff Report

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damon.talley@skofirm.com

270-358-3187

STOLL  
KEENON  
OGDEN

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**Session 2: Recent Developments in Utility Regulation, Part I**  
**Gerald Wuetcher, Stoll Keenon Ogden**

**RECEIVED**

**FEB 09 2018**

**Session 3: Recent Developments in Utility Regulation, Part II**  
**Damon Talley and Gerald Wuetcher, Stoll Keenon Ogden**

**PUBLIC SERVICE  
COMMISSION**

STOLL KEENON OGDEN 

**RECENT DEVELOPMENTS IN UTILITY  
REGULATION**

Presentation to Oldham County Water District Board of Commissioners  
February 13, 2018

Gerald Wuetcher  
Stoll Keenon Ogden PLLC  
gerald.wuetcher@skofirm.com  
<https://twitter.com/gwuetcher>  
(859) 231-3017

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STOLL KEENON OGDEN 

**ORDER OF PRESENTATION**

- Recent News
- Regulation Review
- PSC Personnel
- PSC Reorganization
- Employee Compensation

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STOLL KEENON OGDEN 

**ORDER OF PRESENTATION**

- Nepotism
- Depreciation
- Certificates of Public Convenience  
& Necessity
- Use of Attorneys in PSC  
Proceedings

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STOLL KEENON OGDEN 

## RECENT NEWS

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STOLL KEENON OGDEN 

### RECENT NEWS

- AG Opines that Water Districts May Terminate Water Service For Failure To Pay Garbage Bill
- PSC Threatens Two Water Districts with Involuntary Merger or Receivership
- Court Affirms Imposing Liability for Renter's H<sub>2</sub>O Bills on Landlord

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STOLL KEENON OGDEN 

### RECENT NEWS

- PSC Takes Unauthorized Issuance of Debt Seriously; Public Examination of Water District Commissioners
- KAWC Infrastructure Rider Withdrawn
- PSC Meter Lab To Close
- Boiled H<sub>2</sub>O Advisory Reporting to PSC Terminated

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### RECENT NEWS

- PSC Doubles Down on Water Loss

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### REGULATION REVIEW

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### REGULATORY REVIEW

- 2017 General Assembly enacted HB 50 (Regulatory Sunset Bill)
- Codified at KRS 13A.3102
- An administrative regulation expires after seven (7) years unless certified by promulgating agency
- Regulations promulgated before 7/1/2012 will expire on 7/1/2019

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**REGULATORY REVIEW**

- To avoid expiration, promulgating agency must :
  - Review regulation to determine if it accords with KRS Chapter13A & current subject matter law
  - Certify by Letter to LRC that Regulation will be amended to comply with current law or can remain in effect without amendment

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**REGULATORY REVIEW**

- If regulation requires amendment, agency must submit an amended regulation to LRC within 18 months after submitting certification letter
- If amended regulation not timely submitted, it will lapse

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**REGULATORY REVIEW**

- PSC must review & certify following regulations by 7/1/2019:
  - 807 KAR 5:066 – Water
  - 807 KAR 5:070 – Water District Commissioner Training
  - 807 KAR 5:071 – Sewer
  - 807 KAR 5:090 – System Development Charges
  - 807 KAR 5:095 – Fire Protection for Water Utilities

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STOLL KEENON OGDEN 

## PSC PERSONNEL

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STOLL KEENON OGDEN 

### DEPARTURES

- Jim Gardner (Chair/Vice Chair)
- Daniel Logsden (Commissioner)
- Aaron Greenwell (Deputy Executive Director)
- Ginny Smith (Director, Consumer Services Div.)
- Linda Faulkner (Director, Filings Division)
- Darrell Newby (Director, Financial Analysis)
- Brent Kirtley (Manager, Tariffs Branch)

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STOLL KEENON OGDEN 

### DEPARTURES

- Mark Rashe (Mgr, Engineering H<sub>2</sub>O Branch)
- Scott Lawless (Water & Sewer Branch)
- Jason Pennell (Inspections Division)
- David Spenard (Office of General Counsel)

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### APPOINTMENTS

- Michael J. Schmitt - Chair (Term ends 6/30/2019)
- Robert J. Cicero – Vice Chair (Term ends 6/30/2020)
- Talina Mathews – Comm’ner (Term ends 6/30/2021)
- Gwen R. Pinson – Executive Director
- John S. Lyons – Deputy Executive Director
- Mary Beth Purvis – Manager, Water & Sewer Branch, Financial Analysis Division
- Jeb Pinney – Acting General Counsel

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### PSC FUNDING & ORGANIZATION

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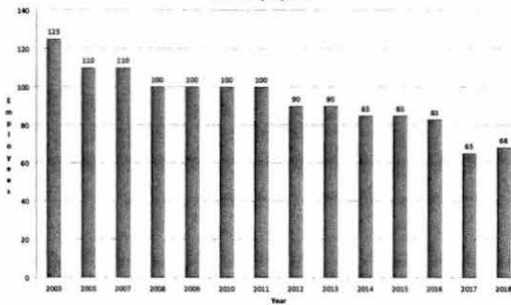
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PSC Employees




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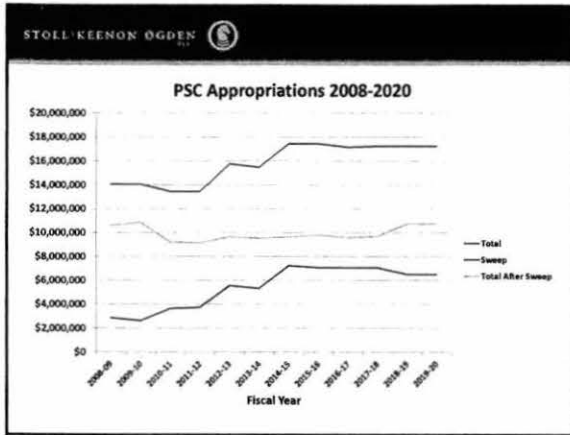
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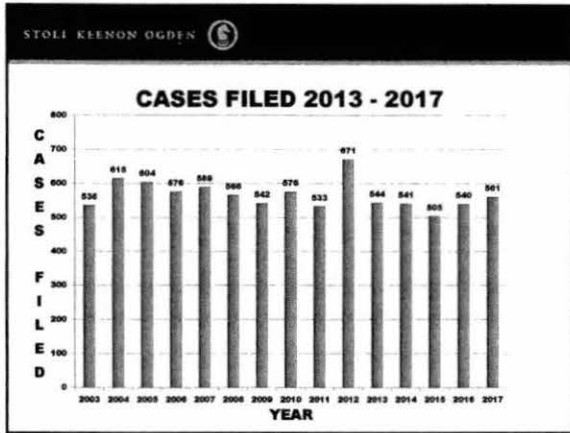
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STOLL KEENON OGDEN

### PSC REORGANIZATION: EXECUTIVE ORDER 2016-832 (11/18/2016)

- Division of Engineering **ABOLISHED**
- Division of Consumer Services **ABOLISHED**
- Division of Filings **ABOLISHED**
- Division of Inspections **CREATED**
- Office of General Counsel **CREATED**
- Division of General Admin **CREATED**

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**PSC REORGANIZATION:  
EXECUTIVE ORDER 2016-832 (11/18/2016)**

- Tariff Branch **ABOLISHED** – functions move to Financial Analysis Division
- Annual Reports & Docket Branches **ABOLISHED** – functions moved to Division of General Administration
- Water & Sewer Rate Design Branch and Water Revenue Requirements Branch **MERGED**

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**PSC REORGANIZATION:  
EXECUTIVE ORDER 2016-832 (11/18/2016)**

- All non-management Engineers transferred to other agencies within Energy & Environment Cabinet
- “The Commission **no longer relies on engineering services** given the evolution of the utility.”
- PSC to rely upon E&E Cabinet personnel for Engineering expertise/advice
- PSC seeking greater inter-agency cooperation
- PSC to emphasize **inspections** and **investigations**

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**PSC ORGANIZATIONAL CHANGES**

- Research Division **Eliminated**
- Financial Audits Branch **Eliminated**
- Management Audits Branch **Eliminated**
- Engineering Division **Eliminated**
- Tariffs Branch **Eliminated**
- GIS Personnel/Services **Eliminated**
- Meter Laboratory **Eliminated**

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**ADAPTING TO THE NEW ENVIRONMENT:  
Part I**

- Incorporate PSC Review Periods Into Planning Process
- Do not Wait Until Last Minute
- More Comprehensive Application
  - Provide Historical Background
  - Provide Greater Narrative/Testimony of Utility Officials
  - Anticipate Requests for Information/Documents & Include
  - Organize Materials to Ensure Easier Review/Reference

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**ADAPTING TO THE NEW ENVIRONMENT:  
Part II**

- Greater Preparation
  - Pre-filing conferences with PSC Staff
  - Identify potential issues prior to filing
  - Review Prior PSC Orders/Proceedings
  - Identify/Gather Evidence & Argument to address potential issues
- Strictly Adhere to Filing Checklists
- Request Deviations From Filing Requirements When Necessary

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**ADAPTING TO THE NEW ENVIRONMENT:  
Part III**

- Contact Potential Intervenors
  - Ascertain Their Positions
  - Explain Your Application/Requested Relief
- Alert PSC Staff to Timing Requirements
- Check Periodically on Status of Proceeding
- Use Electronic Filing Procedures
- Do Not File Application Unless Law Requires

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**ADAPTING TO THE NEW ENVIRONMENT:  
Part IV**

- Longer Review Times Likely
- More Frequent & Lengthy Requests for Information
- Greater Litigation Expense

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**EMPLOYEE  
COMPENSATION**

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**EMPLOYEE COMPENSATION:  
CASE NO. 2015-00312**

- Electric Utility Sought Rate Increase
- Attorney General (AG) raised concerns re: wage & salary increases/fringe benefits
- PSC:
  - Shares AG's concerns
  - No basis in record to justify determination that wages and benefits are not reasonable
  - Notes problems with studies re: wages

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**EMPLOYEE COMPENSATION:  
CASE NO. 2015-00312**

"[T]he Commission believes that employee compensation and benefits need to be more sufficiently researched and studied. The Commission will begin placing more emphasis on evaluating salary and benefits as they relate to competitiveness in a broad marketplace. **Future rate applications will be required to include a salary and benefits survey that is not limited exclusively to electric cooperatives, electric utilities, or other regulated utility companies. The study must include local wage and benefit information for the geographic area where the utility operates and must include state data where available.**"

Order of 9/15/2016 at 15

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**EMPLOYEE COMPENSATION:  
CASE NO. 2016-00054**

- Water District Sought Rate Increase
- PSC Staff challenges annual increases for select employees who receive percentage increases greater than other employees
- PSC **disallowed** higher increases:  
"The annual wage rate increase for all employees should be comparable **unless there is evidence demonstrating a reasonable basis for a different increase amount**, such as when an employee receives a promotion for accepting additional responsibilities."

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**EMPLOYEE COMPENSATION:  
CASE NO. 2016-00054**

- AG challenged wage expense related to annual wage increase of **3% for all employees** & health, life & vision insurance (at no cost)
- PSC rejected challenges and found wage increase & fringe benefit package reasonable
- PSC focus not on reasonableness of the amount of increase but whether **the total salary was unreasonable**

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**EMPLOYEE COMPENSATION:  
CASE NO. 2017-00070**

- Utility examined wages 2X annually:
  - (1) Cost-of-living
  - (2) Performance Evaluation
- Utility did not provide written evaluations
- Utility did not use a defined price index to establish cost-of-living increase
- PSC refused to allow cost-of-living adjustment as improper “**Post-Test Period Adjustment**”

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**EMPLOYEE COMPENSATION:  
CASE NO. 2017-00070**

- **PSC warning to all water utilities:**

**In future rate cases, cost-of-living adjustments without a sound basis, such as a relevant inflation index or written performance-based metric, will be disallowed.**

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**EMPLOYEE COMPENSATION:  
SUPPORTING SALARY/WAGE LEVELS**

- PSC closely reviewing Wage/Salary levels
- Applications for Rate Adjustment should support any adjustment in test period expense
- Comparison with other utilities
  - KRWA Salary Survey
  - Kentucky League of Cities’ Wage and Salary Survey
  - AWWA Wage/Salary Survey
  - Bureau of Labor Statistics
  - PSC Annual Reports

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**EMPLOYEE COMPENSATION:  
SUPPORTING SALARY/WAGE LEVELS**

- When using surveys, ensure appropriate category used
- PSC will closely examine/critique employees in excess of average
- Provide Complete Job Descriptions
- Identify Special Employee Skills & Education
- Emphasize Experience/Longevity w/Utility

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**EMPLOYEE COMPENSATION:  
SUPPORTING COMPENSATION PACKAGE**

- Support for Wage/Salary Increases
  - Consumer Price Index
  - Bureau of Labor Statistics
  - Employee Performance Evaluations
- Identify factors that affect compensation
  - Utility's Location
  - Local Labor Pool
- **Annual Increases In Excess of Cost of Living:**  
PSC expects any increase in excess of cost-of-living to be based upon documented performance
  - Written Performance Evaluations

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**EMPLOYEE COMPENSATION:  
SUPPORTING COMPENSATION PACKAGE**

- Document Wage Decisions
  - Bd Minutes should reflect Bd's reasoning for increases
  - Specific, detailed reasons preferred over general
- Implement Evaluation System to provide better support for selective wage/salary increases
- Avoid across-the-board performance raises

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**EMPLOYEE COMPENSATION:  
SUPPORTING COMPENSATION PACKAGE**

- If Board is the decision-maker, ensure Board witness can articulate basis for decision
- If competition for local labor is basis for increase, provide supporting info re: local labor market

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**EMPLOYEE COMPENSATION:  
BONUSES**

- PSC has historically disallowed bonuses
  - Salary adequate
  - Non-recurring
  - Discretionary
- Question of Lawfulness
  - KY Constitution Section 3
  - OAG 62-1
- Consider Implementing Incentive Compensation Policy to Overcome PSC Objections

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**Commissioners' Salaries/Benefits**

- Have Fiscal Court Ordinances re: salary level available for inspection
- Have proof of training attendance if compensation > \$3,600 awarded
- No free or reduced service
- Insurance benefits should not exceed those provided employees
- Future Issue: Why are benefits other than salary needed?

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**EMPLOYEE COMPENSATION:  
HEALTH INSURANCE**

- PSC reviewing employers' contribution for health insurance cost
- If employer's contribution (%) exceeds national average, PSC **denies recovery** for excess
- PSC directing utilities to establish a policy that requires employees to pay a portion of health & dental insurance

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**EMPLOYEE COMPENSATION:  
HEALTH INSURANCE**

BLS: Estimate of National Average

Coverage	Average	Private Industry	State & Local Government
Family	68/32	67/33	71/29
Single	80/20	79/21	86/14

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**EMPLOYEE COMPENSATION:  
HEALTH INSURANCE**

Kaiser Foundation Report (2016)

- 12% of Covered Workers – Employers paid full cost of single coverage
- 30% of Covered Workers in Small Firms (> 200 employees) – Employers pay full cost
- Covered Workers pay 18% of premium (single coverage) (17% for small firms)
- Public Firms: Workers paid 8% of single coverage (small firms)

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**HEALTH INSURANCE COSTS  
CASE NO. 2016-00169**

- AG challenges utility's 100% payment of health, life & vision insurance premiums
- PSC finds that employer contributions should be "more in line with other businesses" to reduce expenses"
- PSC: Majority of businesses do not pay 100% of employees' insurance costs
- Expenses should be based upon National Average

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**HEALTH INSURANCE COSTS  
CASE NO. 2016-00169**

- National Average based on BLS Study
- Limited to salaried Employees
- Union Employees exempted
- PSC **ORDERS** utility to limit to national average percentages its contributions to employee insurance

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**HEALTH INSURANCE COSTS  
CASE NO. 2016-00365**

- RECC paid for single coverage; employee paid \$149/month for other coverages
- PSC: RECC should limit its contribution to BLS national average employer rate
- PSC: Expects RECC to **establish policy** to limit contribution & require all employees to pay portion of premium
- Portion of health insurance cost disallowed

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**HEALTH INSURANCE COSTS  
CASE NO. 2016-00325**

- Water District paid 100% of insurance cost
- PSC: WD should exercise financial prudence & reduce expense related to employee benefits **by establishing policy** that requires employees to pay a portion of premiums
- Portion of health insurance cost disallowed
- WD given **no notice** of possible action

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**HEALTH INSURANCE COSTS  
CASE NO. 2016-00435**

- Water District paid 100% of insurance cost
- PSC: WD should exercise financial prudence & reduce expense related to employee benefits **by establishing policy** that requires employees to pay a portion of premiums
- Portion of health insurance cost disallowed
- WD given **no notice** of possible action

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**HEALTH INSURANCE COSTS  
CASE NO. 2016-00367**

- RECC paid 100% of insurance cost
- PSC: RECC should exercise financial prudence & reduce expense related to employee benefits **by establishing policy** that requires employees to pay a portion of premiums
- Portion of health insurance cost disallowed

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**HEALTH INSURANCE COSTS  
CASE NO. 2016-00434**

- RECC requires non-union employees to pay 8%, union employees to pay 10% of insurance cost
- PSC: RECC should increase efforts to rein in expenses **by establishing policy** that requires employees to pay an **increased percentage** of premium
- Portion of health insurance cost disallowed

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**HEALTH INSURANCE COSTS  
CASE NO. 2017-00070**

- WD paid 100% of insurance cost
- PSC Staff: Determination of reasonableness of cost should be based upon total compensation paid to employees; WD's overall cost lower than others and should be considered reasonable

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**HEALTH INSURANCE COSTS  
CASE NO. 2017-00070**

- WD at Hearing offered evidence of practices of local job market competitors
- WD questioned:
  - Use of BLS "private firm" percentage
  - Failure to use Government Unit Percentage
  - Why the same rate that KY State Govt not used

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**HEALTH INSURANCE COSTS  
CASE NO. 2017-00070**

- PSC Response:
  - PSC "placing greater on evaluating employees' total compensation packages"
  - Made no evaluation of Utility's package
  - Applied Mandatory Employee Compensation Rule

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**COMMISSIONER CICERO'S POLICY ON  
HEALTH INSURANCE BENEFITS**

- "[F]or rates to be fair, just, and reasonable - both to the ratepayers and the utility - the utility's employees should reasonably participate in the cost of their health and dental insurance premiums
- Absent any employee participation, PSC will apply 21% contribution for single & 32% for family

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**COMMISSIONER CICERO'S POLICY ON  
HEALTH INSURANCE BENEFITS**

The Commission has been questioned as to why it doesn't utilize the statistical percentages for "Service-providing industries – utility category" instead of the "all workers" category. The reason is obvious: if all utilities offer the same program benefits the comparative percentages will be skewed for that category

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**COMMISSIONER CICERO'S POLICY ON HEALTH INSURANCE BENEFITS**

- I will emphasize this point - if the employee percent cost participation is not exactly at the standard percentage levels, but the company does require employee cost participation at a reasonable level, the Commission will not adjust those costs. However, the further the actual percentage is below the standard statistical average percent participation, the greater the probability that the Commission could make an adjustment.

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**HEALTH INSURANCE COSTS DISALLOWED IN 2017-18**

- Last 13 WD rate cases:
  - Rule Applied/Costs disallowed – 9
  - PSC Hearing on Costs – 1 (Disallowed)
  - Allowed – 1
  - No health insurance costs – 3

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**PROBLEMS WITH PSC APPROACH**

- Due Process Concerns
  - No notice to utilities
  - Utility has no opportunity to confront BLS "National Average" Statistics
- KRS Chapter 13A: PSC adopts a rule without following proper procedure
- PSC Assumption: Utility Industry payment of insurance costs is "skewed" – utilities pay 100% of costs (BLS does not support assumption that utilities pay 100%)

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**PROBLEMS WITH PSC APPROACH**

- Improper Use of BLS Statistics
  - No recognition of Distinct Local Gov't Data
  - Refusal to Use "Utilities Information"
  - Never Finds Current Compensation Costs Unreasonable
- PSC refuses to consider:
  - Insurance Policies of Utility
  - Local Labor Markets
  - Utilities' Efforts to contain/reduce health insurance costs
  - Reputable/recognized studies on issue

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**RESPONSES TO PSC APPROACH**

- Use Good Procurement Practices
  - Request Bids/Seek cost estimates from various suppliers annually
  - Document/Demonstrate Cost was reasonable
- Compare **Total Compensation Cost** vs. Other Regulated Utilities/Municipal Utilities
- Introduce Evidence of Local Labor Markets
- Emphasis Unique Nature of Workforce

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**RESPONSES TO PSC APPROACH**

- Consider differences between the quality of WD's insurance coverage & National Average Policy (e.g. deductibles)
- Challenge Use of National Average – Use Government Category
- Use a different study for National Average (e.g., Kaiser Family Foundation)
- Assert Due Process Concerns

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STOLL KEENON OGDEN 

## NEPOTISM

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STOLL KEENON OGDEN 

### NEPOTISM

- Greater PSC Interest in Utilities' Nepotism Policies
  - Standard Request in RECC rate cases
  - Statement of Related Transactions Required in Most H<sub>2</sub>O Rate Cases
- Case No. 2016-00169:
  - PSC critical of RECC for hiring CEO's relatives
  - Ordered that RECC's exception to Nepotism Policy be eliminated

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STOLL KEENON OGDEN 

### PSC ON NEPOTISM

"[I]t is bad business practice to [employ] . . . relatives, especially relatives of management or board members, because there is a natural tendency to favor relatives."

Case No. 2016-00169, Order of 2/6/2017 at 25

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### NEPOTISM

- Review County Ethics Ordinance Re: Nepotism
- Comply with Ordinance
- Consider Supplementing If Ordinance is Inadequate
- Board Members/Management Have Duty to Disclose (ARF Form 3)
- Annual Review/Refresher
- Fully document/explain any exceptions in Board Minutes

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### DEPRECIATION

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### DEPRECIATION

**"[D]epreciation** is the loss, not restored by current maintenance, which is due to all the factors causing the ultimate retirement of the property. These factors embrace wear and tear, decay, inadequacy, and obsolescence. **Annual depreciation** is the loss which takes place in a year. In determining reasonable rates for supplying public service, it is proper to include . . . an allowance for consumption of capital . . ."

*Lindheimer v. Illinois Bell Tele. Co., 292 U.S. 151, 167 (1934)*

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## DEPRECIATION

- Depreciation Permits Recovery of the Cost of A Capital Asset
- Annual Depreciation Expense =  $(\text{Asset Cost} - \text{Salvage Value}) \div \text{Useful Life (years)}$
- Two Critical Components
  - Asset Cost
  - Useful Life

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## USEFUL LIFE: EFFECT ON REVENUE REQUIREMENT

**Assume: \$10 Million Water Mains**

Useful Life (Years)	Annual Depreciation Expense
25	\$400,000
30	\$333,334
40	\$250,000
50	\$200,000
62.5	\$160,000
75	\$133,334

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## EFFECT OF USEFUL LIFE ON REVENUE REQUIREMENT

- Increases/Decreases Revenue Requirement
- Erroneous Useful Life creates
  - Generational Inequities (Earlier Generation pays for Asset that a Later Generation Uses)
  - Inadequate Revenue for Infrastructure Replacement
  - "Money Left on Table" That Utility Never Recovers (PSC Staff)

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**METHODS FOR DETERMINING  
ASSET'S USEFUL LIFE**

- Engineering Estimate/Judgment
- Depreciation Study
- NARUC's *Depreciation Practices for Small Water Utilities*

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**DEPRECIATION STUDIES:  
GENERALLY**

- Involves an analysis of past performance and engineering estimates of future
- Requires detailed historical records (30 Years) re: plant additions and retirements
- Survivor Curves plotted
- Supplemented with information from management and operating personnel re: current plant operations & practices
- Interpretation

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**PSC RE: USE OF DEPRECIATION  
STUDIES FOR SMALLER UTILITIES**

Detailed property records specific to historic plant additions, plant retirements, and salvage practices are required to complete a depreciation study. Generally, "small" water utilities, such as Pendleton District, do not maintain property records with enough detail to properly complete a formal study. Furthermore, even if adequate records were maintained, "small" utilities do not have the financial resources to fund a formal study.

Case No. 2012-00412, PSC Staff Report at 9-10.

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**Depreciation Practices For Small Utilities**

- National Association of Regulatory Utility Commissioners (NARUC) Publication (Aug. 15, 1979)
- Intended to address the needs of regulatory commissions to establish realistic depreciation rates for small H<sub>2</sub>O utilities
- Provided in table format a range of average service lives then in use by H<sub>2</sub>O utilities throughout the US for H<sub>2</sub>O facilities designed & installed & maintained in accordance with good H<sub>2</sub>O works practice



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**Depreciation Practices For Small Utilities**

"The commission has previously used . . . [the NARUC] survey when establishing the appropriate depreciable lives for water utilities such as Rattlesnake Ridge when historic property records are not maintained in the manner necessary to perform a formal depreciation study or the utility does not have the financial resources to fund a formal study. Application of the NARUC Study is appropriate in this instance."

Case No. 2013-00338, Order of 02/07/2014 at 4.

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**Depreciation Practices For Small Utilities**

"Since the depreciable lives in the NARUC Study are similar to those of an average utility, the NARUC Study may be used to evaluate the reasonableness of the depreciation practices of water districts and water associations without regard to the number of customers they serve or the amount of annual revenues and plant investment they report."

Case No. 2016-00163, Order of 11/10/2016 at 17.

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**Depreciation Practices For Small Utilities**

“Although significant time has elapsed since its issuance, the NARUC Study presents a conservative estimate of the anticipated useful life of water mains that are constructed of either iron, PVC, galvanized steel, or concrete.”

Case No. 2016-00163, Order of 11/10/2016 at 17.

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**PSC TREATMENT OF USEFUL LIVES**

- Recent Focus on Useful Lives (Mains/Meters)
- PSC Staff Routinely Recommending Changes To Conform to NARUC Guide

Year	Total Cases	Revised Useful Lives
2012	8	5
2013	4	3
2014	6	5
2015	8	7
2016	9	9
2017	3	3

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**PSC STAFF APPROACH**

- Prior to Nov. 2016:
  - Utility's Useful lives are within NARUC Range – No Change
  - Useful Lives Outside NARUC Range – Revise to Mid-Range
- Since Nov. 2016: In absence of evidence to support specific useful life, the NARUC mid-point will be used

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### PSC STAFF APPROACH

- Factors Considered:
  - Asset's construction materials
  - Asset's condition
  - Other Factors
- PSC Non-Engineering Staff may exercise "engineering judgment"

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### RESPONSE TO STAFF RECOMMENDATION

- Recommendation contested twice
- Why?
  - Contest would delay rate increase
  - Cost of contesting
  - Surprise
  - Limited time to respond/Lack of expertise
  - Limited benefit: Staff recommended rate increase near requested amount

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### PSC DECISIONS RE: DEPRECIATION

- Utility bears Burden of Proof to Demonstrate Why Its Current Useful Life Is Appropriate
- In absence of evidence to the contrary, NARUC Guide mid-point will be used
- PSC has not required PSC Staff proposals to be supported by engineering/technical evidence when maximum range recommended
- Staff Recommendations adopted in **ALL** Cases
- Adopted for **Ratemaking & Accounting** Purposes

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**IMPACT OF DISALLOWANCE**

Case No.	Disallowance	Requested Increase	Percentage
2016-00377	\$ 88,020	\$ 151,676	58.03%
2016-00265	\$ 31,175	\$ 161,422	19.31%
2016-00177	\$ 48,822	\$ 118,913	41.06%
2016-00163	\$ 66,141	\$ 324,726	20.37%
2016-00068	\$ 93,784	\$ 165,260	56.75%
2016-00054	\$ 167,568	\$ 374,168	44.78%
2015-00428	\$ 41,123	\$ 701,615	5.86%
2015-00341	\$ 88,792	\$ 486,222	18.26%
2015-00331	\$ 22,414	\$ 64,514	34.74%
2015-00308	\$ 3,350	\$ 255,707	1.31%

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**STEPS TO AVOID OR REDUCE DISALLOWANCE IN RATE CASE: PRE-APPLICATION**

- Review Useful Lives – Are they within NARUC range? (Emphasize Mains/Meters)
- Revise for Compliance with Lower Range (Unless basis for variance)
- Estimate effect of Revision on Revenue Requirement at Mid-Point & Higher Range
- If Effects of Mid-Point/Higher Range Revision Significant, Include **Supporting Evidence** for Useful Lives in Application

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**STEPS TO AVOID OR REDUCE DISALLOWANCE IN RATE CASE: PRE-APPLICATION**

- Review Asset Management Plan/Water Main Replacement Plan
- No Plan:
  - Develop plan
  - Emphasize replacement of water mains near the end of useful lives

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**TYPES OF SUPPORTING EVIDENCE**

- Past PSC Treatment of Depreciation Expense
- Depreciation Study
  - Adequate Records?
  - Potential Cost
- Engineer Testimony
  - Sworn Affidavit
  - How committed is your Engineer?

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**ENGINEER AFFIDAVIT CONTENTS:  
PART I**

- Education Background
- Professional Licenses/Memberships
- General Experience in Water Industry
- Description of Utility Facilities/Past History
- Experience with the Utility's Operations & Facilities
- Alternative to Experience with Utility
  - > Review of Utility Records
  - > Interviews of Prior Engineering Firms & Utility Personnel
  - > Investigation of Construction Firms Performing Work

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**ENGINEER AFFIDAVIT CONTENTS:  
PART II**

- > Personal Experience with Contractors/Materials in work for other utilities
- > Industry Experience with Materials/Facilities
- Opinion re: useful lives
- Reasoning for Opinion

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**STEPS TO AVOID OR REDUCE  
DISALLOWANCE: STAFF SITE INSPECTION**

- Exercise Care with Staff Inquiries re: utility facilities
- Utility should designate one person to answer inquiries – (Engineer)
- Request that inquiries be in writing & respond in writing
- If Interview, conduct in presence of attorney or witness/record interview

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**STEPS TO AVOID OR REDUCE  
DISALLOWANCE: AFTER THE STAFF REPORT**

- Review Staff Report
  - Is Disallowance of Depreciation Expense Recommended?
  - Does recommended Revenue Requirement (RR) meet utility's needs?
  - What is the effect on RR if utility's proposed depreciation expense level accepted?
  - If acceptance of proposed depreciation expense level would generate higher RR than requested, can utility responsibly use the additional funds?

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**STEPS TO AVOID OR REDUCE DISALLOWANCE:  
AFTER THE STAFF REPORT – RATES ACCEPTABLE**

- Conditional Waiver/Acceptance
  - Waive all rights & Accept Recommended RR and rates on condition PSC addresses only those 2 issues
  - No PSC ruling on other Staff recommendations
  - Still Note Objections to Report/Contested Issues
- Alternative Request for Relief
  - Full Discovery including depositions
  - Hearing
  - Separation/Isolation of Assigned Staff

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**STEPS TO AVOID OR REDUCE DISALLOWANCE:  
AFTER THE STAFF REPORT - RATES UNACCEPTABLE**

- Note Objections/Contested Issues
- Contested Issues (Depreciation Only)
  - Prior PSC Position on Depreciation in Prior Cases
  - Legal Objections to Use of NARUC Guidelines
  - Policy/Fact Objections to Use or Application of NARUC Guidelines
  - Staff Qualifications to Render Opinion
  - Met Standard (Within Range And Produced Evidence)
- Procedural Requests (Same as Alternative Relief)

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**DEPRECIATION: SUMMARY**

- **Major Issue** in Water Utility Rate Cases
- Examine Useful Lives **NOW**/Determine if Valid
- **(BEFORE FILING APPLICATION)** Assess Effects on RR of Major Revisions in Useful Lives
- Address in Application for Rate Adjustment
- Start Maintaining Records to Perform Depreciation Study

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**DEPRECIATION: SUMMARY**

- Consider Conditional Waiver To Avoid Expensive and Unproductive Litigation
- Preparation Costs Can Be **Recovered As Rate Case Expenses**

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## USE OF ATTORNEYS IN PSC PROCEEDINGS

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### PSC REGULATIONS RE: ATTORNEYS

- 807 KAR 5:001, §4(3): "Papers" must be signed by party or **attorney**
- 807 KAR 5:001, §4(4): A person shall not file a paper on behalf of another person, or otherwise represent another person, unless the person is an attorney licensed to practice law in Kentucky or an attorney who has complied with SCR 3.030(2)."
- Paper is any "document that [PSC Rules] or the Commission directs or permits a party to file in a case"
- Bottom Line: Unless pro se representation, all documents filed in any formal PSC proceeding must be filed by an Attorney

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### NO ATTORNEY REQUIRED

- Tariff Filings
- Correspondence with PSC Executive Director or other officers (e.g., Response to PSC Staff Inquiry)
- Required Filings outside of Formal Proceedings
  - Annual Reports
  - Regulatory Reports (e.g., Meter Testing)
  - Audit Reports
  - Commissioner Vacancy/Appointments
  - Change/Confirmation of E-mail Address
- Non-recurring Charge Filings
- Request for Staff Opinions

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**ATTORNEY REQUIRED**

- Certificates of Public Convenience and Necessity
- Authorization to Issue Debt/Securities
- Applications for Declaratory Ruling
- PSC Formal Investigations
- Rate Proceedings
  - Suspended Tariff Revisions/Non-Recurring Charges
  - General Rate Adjustments

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**ATTORNEY REQUIRED**

- Request for Deviations

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**ALTERNATIVE RATE FILINGS**

- 807 KAR 5:076, §13
- No Attorney is required to:
  - File application
  - Respond to information requests
  - Appear at conferences
  - Submit Response to Staff Report
- Attorney Required Only for Hearings

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**ASSESSING NEED FOR ATTORNEY**

- How Familiar Is Utility With Process?
- Opposition/Intervenors Expected?
- Complicated Issues?
  - Depreciation
  - Debt Service
  - Rate Design
  - Unusual Expenses
- Likelihood of Hearing?
- Cost – How much can Utility afford?

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**ASSESSING NEED FOR ATTORNEY**

- Purposes for Retaining Lawyer:
  - Identify/Address Potential Ratemaking Problems
  - Avoid Procedural Delays (Delay = \$\$\$)
  - Counterweight to PSC Staff/AG/Other Intervenors
  - Prepare for Hearing
- How much lawyer is needed?
  - Standby/limited oversight
  - Full Participation
- How Familiar is Lawyer with the PSC Process?

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**ASSESSING NEED FOR ATTORNEY**

- Fees:
  - Fixed Fee for Expected Services
  - Fixed Fee/Retainer: Max Fee but Charge Per Hour until Max
  - Contingency: Hourly Rate if Hearing
  - County Attorney (No Fee)
  - Lower Rate/Lesser Involvement in Later Cases
- Fees Recoverable as Rate Case Expense
  - Expenses to Prepare/Review Application
  - Rate Request should include **Maximum Possible Fees**

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**WHAT CONSTRUCTION  
PROJECTS REQUIRE PSC  
APPROVAL?**

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**KRS 278.020(1)**

No person, partnership, public or private corporation, or combination thereof shall . . . **begin the construction of any plant, equipment, property, or facility** for furnishing to the public any of the services enumerated in KRS 278.010, except . . . **ordinary extensions of existing systems in the usual course of business**, until that person has obtained from the Public Service Commission a certificate that public convenience and necessity require the service or construction.

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**PROJECTS REQUIRING A  
CERTIFICATE**

- Construction of Any Plant or Facility
- Installation of Equipment on Large Scale (e.g., metering equipment)
- Repurposing of An Existing Facility
- Pre-Construction Contracting
- Acquisition of Facility???

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**DOES NOT REQUIRE A CERTIFICATE**

- Purchase of Building or Land
- Maintenance/Replacement Projects
- Demolition/Destruction of Existing Facility
- Acquisition of Non-Jurisdictional Facilities
- **Extensions In the Ordinary Course**

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**EXTENSIONS IN THE ORDINARY COURSE**

"A certificate of public convenience and necessity shall not be required for extensions that do not create wasteful duplication of plant, equipment, property or facilities, or conflict with the existing certificates or service of other utilities operating in the same area and under the jurisdiction of the commission that are in the general or contiguous area in which the utility renders service, and that do not involve sufficient capital outlay to materially affect the existing financial condition of the utility involved, or will not result in increased charges to its customers."

807 KAR 5:001, §13(3)

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**EXTENSIONS IN THE ORDINARY COURSE:  
THE FACTORS**

- No **Wasteful** Duplication of Plant or Facilities
- No Conflict With Existing Certificates or Service of Other Utilities
- Capital Outlay Is Insufficient to **Materially Affect** Existing Financial Condition of Utility
- Will Not Result In **Increased Charges** to Customers

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STOLL KEENON OGDEN

### EXTENSIONS IN THE ORDINARY COURSE: WASTEFUL DUPLICATION

- "Excess of Capacity Over Need"
- "Excessive Investment In Relation To Productivity" – Investment's Cost-effectiveness
- Unnecessary Multiplicity of Physical Properties
- Premature Replacement
- **Any Duplication Requires Formal Review**

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STOLL KEENON OGDEN

### EXTENSIONS IN THE ORDINARY COURSE: MATERIALLY AFFECT

- Percentage of Net Utility Plant
  - Ordinary if less than 10% (**Abandoned**)
  - 2 Percent Rule (Staff Opinions)
  - 1 Percent Rule – Case No. 2014-00171
- Revenue Neutral – Project generates sufficient revenues to meet expense, then Ordinary
- Debt-Financed (**Conflicting Opinions**)

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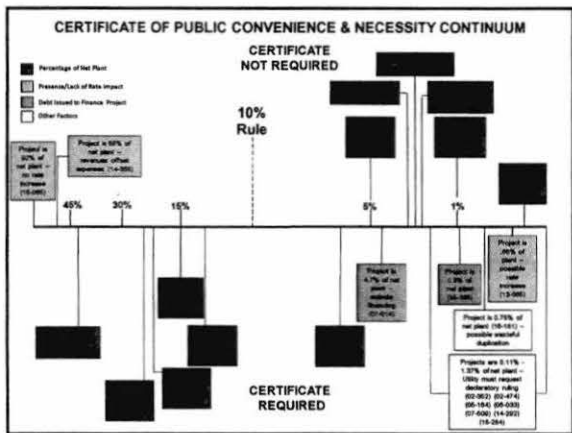
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### BUDGET ACT "BRIGHT LINE TEST"

- Contained in Biennial Budget Act
- No Certificate of Public Convenience & Necessity if:
  - Total Cost < \$500,000 **OR**
  - Project does not involve issuance of debt requiring PSC approval AND no rate increase will result
- Applicable only to **Class A & B** Water Districts & Associations
- Expires at end of Biennium Unless Reauthorized
- Applies to "**water line extension or improvement project**"

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### BUDGET ACT "BRIGHT LINE TEST"

- PSC Has Limited Applicability To Water Mains
- Case No. 2016-00255 – Installation Of An Automated Meter System (08/03/2016)
- Held: "[T]he proposed installation of the new metering system is not a 'waterline extension or improvement project,' as it **does not extend or improve an existing waterline**"
- Adopts reasoning of PSC Staff Opinion No. 2012-024 (12/19/2012)

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### BUDGET ACT "BRIGHT LINE TEST"

**Is a "water main improvement project" limited to construction of water mains only?**

- PSC Staff Opinion No. 2017-002
- Water Association proposes to construct water booster station, including 300 feet of 2" water line, & install pressure reducing valve
- PSC Staff: "[T]he project improves existing water lines and qualifies as a 'water line extension or improvement project.'"
- Project involving non-mains may qualify if beneficial effect on existing water mains

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### METHOD OF ANALYSIS

- Bright Line Test Applicable?
  - Water Main Extension or Improvement?
  - \$500,000 or less?
  - No debt issued & no rate increase required?
- Construction of Facility OR Large Scale Installation of Equipment?
- Purchase?
- Replacement/Maintenance?
- Directly Debt Financed?
- Percentage of Net Utility Plant

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### WHEN IN DOUBT

- CYA: Private Attorney Opinion Letter
  - Rigorous/Thorough Analysis Essential
- Avoid Requests for Staff Opinion
- DO **NOT** Request A Deviation - Not Permitted Under Statute
- Request Declaratory Order
- File Application for a Certificate

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### CONSTRUCTING WITHOUT CERTIFICATE: CONSEQUENCES

- Assessment of \$2,500 Penalty To:
  - Utility
  - Utility Management
  - Engineering Firm/Contractors
- Injunctive Relief
- Does Not Affect Rate Recovery

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**RURAL DEVELOPMENT FUNDING:  
AVOIDING PSC REVIEW**

- KRS 278.023 requires expedited review of RD-funded Projects
- Legislature Assumes RD has adequately reviewed project – Two reviews unnecessary
- Project must be part of Financing Agreement between RD or HUD and WD or WA
- Utility Files Limited Documentation

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**RURAL DEVELOPMENT FUNDING:  
AVOIDING PSC REVIEW**

- PSC may recommend changes to proposed construction
- PSC must **APPROVE** the project within 30 days of completed application
- Approval includes all actions necessary to implement agreement (rates, financing, certificate)

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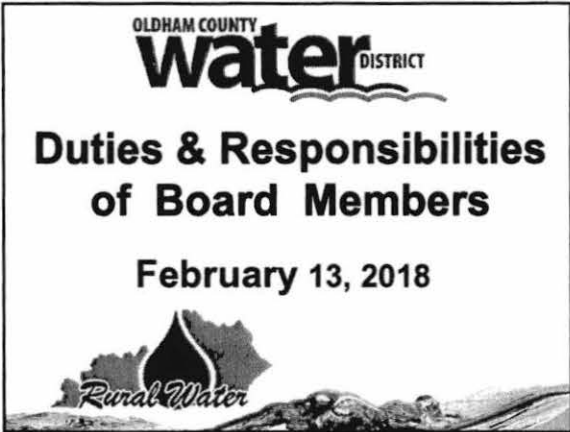
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FEB 09 2018

PUBLIC SERVICE  
COMMISSION

**Session 4: Duties and Responsibilities of Board Members**  
**Damon Talley, Stoll Keenon Ogden**




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**PART I**  
BOARD MEETINGS

**PART II**  
ROLE OF WATER  
DISTRICT COMMISSIONERS

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# PSA for PSC



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## Reporting Requirements

- Must Notify PSC . . .
  - After Vacancy
  - After Appointment
- When?      Within 30 Days

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## Vacancy

- Inform CJE 60 Days Before Term Ends (KRS 65.008)
- CJE / Fiscal Court – 90 Days
- Then, PSC Takes Over
  - CJE Loses Right To Appoint

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## PART I

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## Board Meetings



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## **Board Meetings**

- Preparing for . . .
- Conducting . . .
- Documenting . . .  
(Minutes)

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## **Regular Meetings**

- Adopt a regular meeting schedule
  - Set time, date and location
- Inform the Media (radio, print, television)
- Inform the Public (bills, website, newsletter)

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## **Preparing for Meetings**

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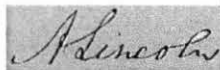
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“Give me six hours to chop down a tree and I will spend the first four sharpening the axe.”



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### Preparing for Meetings

- Develop an Agenda
  - Chairman
  - Manager
- Prepare an Information Packet for Board Members
  - Delivered in advance (between two days and one week)

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### Board Packet

- Contents
  - Meeting Agenda
  - Minutes of prior meeting
  - Operational, Managerial & Financial Reports
  - Other information

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## **Conduct of Meetings**

- Follow the Agenda
- Use Parliamentary Procedure
- Voting by Chairman or President
- Abstaining from Voting
- Public Comments
- Closed (Executive) Session

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## **ABSTAINING FROM VOTING**

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## **WHY Abstain?**

- Avoid conflict of interest
- Avoid being removed from office for violating KRS 74.020(3)  
(Participating in official action which results in direct financial benefit to Commissioner)
- Avoid appearance of impropriety

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## HOW to Abstain

1. Alert Chairman or Presiding Officer in advance
2. Announce intent to abstain and a brief reason as soon as Chairman announces the agenda item  
[Disclose Conflict]
3. Leave the room before discussion starts

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## HOW to Abstain ...

4. Stay out of the room until **AFTER** vote has been taken and announced
5. Follow-up with Secretary to ensure that Minutes disclose your conflict and document your abstention

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## Duties of a Board

1. Specific
2. General

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**Example of Specific Duties**

- Adopt Budget
- Periodically Review Budget
- Amend Budget as Necessary

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**Budgets**

- Required by KRS 65A.080(1)
- Post on DLG Website
- Periodic Review of Budget
- Amend as Necessary
- Post Amended Budget on DLG Website

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**Budgets**

**“No moneys shall be expended from any source except as provided in the originally adopted or subsequently amended budget.”**

**KRS 65A.080(1)**

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## Budget

- Review Actual \$ to Budget \$
- Amend Budget if Needed
- When?
  - October Meeting
  - December Meeting
- Upload to DLG Website

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## General Duties of a Board

1. Oversight
2. Oversight
3. Oversight

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## Oversight

- Method
  - Stay Informed
  - Adopt Policies
  - Require Reports

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## Reports

- Different Types
- Tailored to Fit
- Board Action Required?

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## Types of Reports

- Financial
- Operational
- Managerial
- Other

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## Financial Reports

- Check Register
- Monthly Income & Expense
  - Debt Service Transfer
  - Depreciation Transfer
- Comparisons & Trends
  - Prior Year
  - Budget
- Balance Sheet

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## **Operational Reports**

- Water Production (Purchases)
- Line Loss
- New Customers
- Turn-Offs
- Others

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## **Managerial Reports**

- Safety
- Human Resources
- Special Projects
- Policy Implementation
- Others (e.g. Overtime Hours)

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## **Reports Tailored to Fit**

- Line Loss
  - Actual Cost in \$
- Specific Needs
- Understandable
- You Are The Boss

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## Board Action Required?

- Usually Not
  - Manager Presented . . . .
  - Board Received . . . .
- Sometimes Yes
  - Audit
  - Committee Report

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## Special Meetings

- Who calls a special meeting?
- Notice of meeting
  - Board Members, Media, General Public
- Agenda – action limited to agenda items
- How much advance notice is required?

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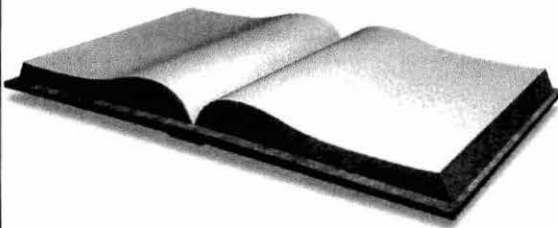
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## MINUTES



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## What Are MINUTES?

- Official Record
- Much, Much More . . .

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## Excerpt From Minutes

"Motion was made by Commissioner X and seconded by Commissioner Y to hire Commissioner Z to perform water line inspections on the Knob Hill Project at an hourly rate of \$20."

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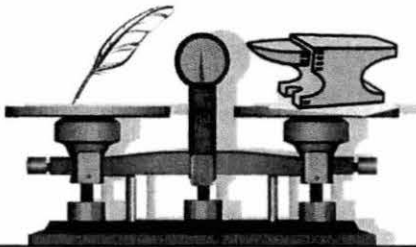
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**AN OUNCE  
OF  
PREVENTION = A POUND  
OF CURE**



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## Board Minutes

- A Board “speaks only through its minutes.”
- War Stories:
  - Ownership of water line and service of disputed territory
  - Careless Conversations

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## Preparation of Minutes

- Who prepares minutes?
  - Board Secretary or Staff
- Who edits minutes?
  - Staff or legal counsel
- Are meetings recorded on audio and/or video?
- Signing of Minutes
- Approval of Minutes

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### ADJOURNMENT

There being no further business to come before the meeting, motion was made by Commissioner Steven Douglas and seconded by Commissioner Henry Clay to adjourn the meeting. Motion carried unanimously.

**Respectfully submitted,**

BY: \_\_\_\_\_

**Henry Clay, Secretary  
ABRAHAM LINCOLN WATER  
DISTRICT**

DATE APPROVED: \_\_\_\_\_

BY: \_\_\_\_\_  
**Jefferson Davis, Chairman**

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### Approval Of Minutes

I hereby certify that the foregoing Minutes were duly approved by the Board of Commissioners of the Abraham Lincoln Water District at a meeting held on the date shown below:

ABRAHAM LINCOLN WATER DISTRICT

BY: \_\_\_\_\_  
JEFFERSON DAVIS, CHAIRMAN

DATE APPROVED: \_\_\_\_\_

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### Board Minutes

A complete set of APPROVED Minutes SHALL be maintained at the utility office for inspection by the general public, regulators, customers, and the media.

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### Board Minutes

When are the Minutes considered in "final form" and available for public inspection?

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## Minutes

### What **MUST** Be Included?

- Board Member Attendance
- Official Actions

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## Minutes

### What **SHOULD** Be Included?

- Board Member Attendance
- Acknowledge Guests (Visitors)
- Official Actions
- Acknowledge Receipt of Reports
  - PSC Inspection Report

Cont.

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## Minutes

### What **SHOULD** Be Included?

- Summarize **Some** Discussions
  
- Toot Your Own Horn



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## Minutes

### Tooting Your Own Horn

- Give Yourself Credit
  - "Best Tasting Water"
  - Wooden Bucket Award
  - AWOP Award
  - Governor's Safety Award

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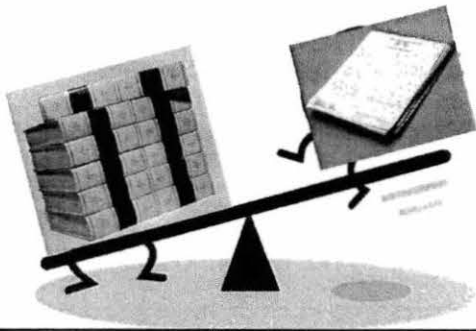
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How much information **SHOULD** be included in the MINUTES?



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## Minutes

How **MUCH** is too **MUCH**?

- No definitive answer
- Art not a science

Cont.

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## Minutes ...

### How MUCH is too MUCH?

- Guidelines . . . .
  - > Minutes are **NOT** a transcript
  - > Minutes are **NOT** the Congressional Record
  - > Include rationale for action taken if it might avoid lawsuit

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**“Conversations are  
NOT official actions  
of the Board.”**

Virginia W. Gregg  
PSC Staff Attorney

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### **WHY Include Summary of Conversations in Minutes?**

- Document Board’s Due Diligence (e.g. Use of safety equipment; Training of Staff re confined space entry)
- Document Board’s Oversight Role (e.g. Implementation of ID Theft Prevention Program)
- Avoid or Win Litigation

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# TALLEY'S TIPS

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## Talley's Tips

### Prepare Minutes for a Reader ...

1. Who did not attend the meeting.
2. Who will not read the Minutes until at least one year later.
3. Who will access Minutes via www.

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## PART II

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**ROLE OF WATER  
DISTRICT  
COMMISSIONERS**

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**To Govern...**  
  
**not**  
  
**...Manage.**

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**General Duties of a Board**

1. Oversight
2. Oversight
3. Oversight

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### **Specific Duties of a Board**

- Hire, evaluate and compensate a Manager
- Adopt Policies
- Adopt and Amend Budgets
- Adopt Long-range Plans
- Adopt Rates, Rules & Regulations (Tariffs)

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### **Individual Board Members...**

**... act in the best interest of the utility.**

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### **Specific Duties of Board Members**

- Stay informed
- Attend meetings regularly
- Perform tasks assigned by Board
- Support decisions of the Board
- Keep Board matters confidential
- Avoid Conflict of Interest

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## Identity Theft



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### Identity Theft Prevention Program

1. Develop Written Program
  - Detect
  - Prevent
  - Mitigate
2. Approved by Board
3. Oversight by Board or Senior Management

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### What Should You Do?

#### Board Members:

- Direct Management to prepare written summary of existing safeguards
- Evaluate existing safeguards
- Work with Management to improve safeguards
- Adopt policy
- Oversee implementation of policy

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## What Should You Do?

### Management:

- Prepare written summary of existing safeguards
- Evaluate existing safeguards
- Work with Board to improve safeguards
- Recommend policy for adoption by Board
- Implement policy
- Train Staff

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## Board Officers

### Offices of a Water District

#### KRS 74.020(5)

- Chairman
- Vice Chairman
- Secretary
- Treasurer
- Others

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## Duties of Officers

### Chairman

- Preside over meetings
- Prepare meeting agendas
- Call special meetings
- Execute documents approved by Board
- Perform other duties assigned by Board
- Approve Disbursements (KRS 74.050)
- Perform other duties specified in Bylaws or Ordinance

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## Duties of Officers

### Vice Chairman

- No statutory duties (Water District or Utility Commission)
- Preside over meetings in absence of Chairman or President
- Perform other duties assigned by Board
- Approve Disbursements (KRS 74.050)
- Perform other duties specified in Bylaws or Ordinance

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## Duties of Officers

### Secretary

- Cause the Minutes of all meetings to be prepared
- Act as custodian of official records
- Authenticate official records
- Perform other duties assigned by Board
- Approve Disbursements (KRS 74.050)
- Perform other duties specified in Bylaws or Ordinance

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## Duties of Officers

### Treasurer

- Cause all funds to be disbursed according to law and procedures adopted by Board (KRS 74.050)
- Perform other duties assigned by Board
- Perform other duties specified in Bylaws or Ordinance

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**Action By Individual Board Members Outside of Meetings**

- Officers
- Other Board Members

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**Legal Standard of Care**

**The "PIG" Rule**

If it seems "piggish" to you, it probably is!  
...so keep your snout in your own trough!



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**Legal Standard of Care**

**Water Dist. & Utility Commission**

No statutory standard of care but the case law standard requires...

- Good faith
  - Reasonable care and diligence
  - Acting within the scope of authority
- The statutory standard of care for water association directors is instructive for water districts and utility commissions.*

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## Legal Standard of Care

### Water Associations (KRS 273.215)

A Director shall discharge his duties:

- In good faith
- On an "informed basis"
- In the best interests of the Association

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### "Informed Basis" KRS 273.215(2)

A director shall be considered to discharge his duties on an informed basis if he makes, with the care an ordinarily prudent person in a like position would exercise under similar circumstances, inquiry into the business and affairs of the corporation or into a particular action to be taken or decision to be made.

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## Legal Standard of Care

### Reliance on Information KRS 273.215(3)

A director is entitled to rely on information, opinions, reports or statements, including financial statements and other financial data, if prepared or presented by:

- Officers or employees of the corporation whom the director honestly believes to be reliable and competent;

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## Legal Standard of Care

### Reliance on Information KRS 273.215(3)

- Legal counsel, public accountants or other experts as to matters the director honestly believes to be within that expert's area of expertise; or
- A committee of the board of directors of which he is not a member if the director honestly believes the committee merits confidence.

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## Legal Standard of Care

Exceptions may be made in instances where a director possesses special knowledge that indicates alternative action is prudent and necessary.

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## Parting Thought

Every utility's Board should develop and adopt a "Board Governance & Policy Manual."

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**QUESTIONS?**

damon.talley@skofirm.com  
270-358-3187

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## **Auditor of Public Accounts**

### **Recommendations for Public and Nonprofit Boards**

*Revised 3/4/10*

The Auditor of Public Accounts, as a result of recent investigations, makes the following recommendations to assist public and nonprofit Boards in designing and implementing internal controls. These recommendations should assist Board members in providing appropriate financial oversight. The following is a brief summary of various financial policy areas that Board members should consider. After each control area is considered, a policy should be developed to address the specific business model of the organization.

1. The Board should have a well defined, clear mission statement to serve as a platform for policies, operational plans, and resource allocations that further the interest of its organization's members.
2. The Board should facilitate the development of an annual orientation program and manual for new and returning Board members to ensure an understanding of the Board's structure, operations, and their legal and fiduciary responsibilities. An explanation of the budget and accounting structure, as well as revenue and investment information should also be included. If possible, the orientation should be facilitated by a knowledgeable, independent party, such as a Board attorney or consultant.
3. The Board should ensure that its organizational structure maintains a flexibility that allows for multiple sources of information. The Board should request reports from individuals having responsibility for various program areas rather than from just the chief executive.
4. The Board meeting minutes should document the exact nature of the financial reviews conducted by the Board. Any issues that result from these reviews and action taken to resolve the issues should also be documented.
5. For Boards who fall under the open meetings law, sessions closed to the public should be entered into in accordance with KRS 61.810. Any conclusions or decisions reached during a session closed to the public must be documented in the Board meeting minutes as stated in KRS 61.815, clarified in OAG 81-387.
6. The Board should establish an independent process to receive, analyze, investigate, and resolve concerns related to the organization including anonymous concerns. Employees, business associates, customers, or the general public may have significant, beneficial information that they are uncomfortable reporting directly to the Board. A toll-free complaint number or an advertised email and postal address for feedback would allow the



transmission of this information. In addition, where applicable, the Board's policy should include a reference to Kentucky law (KRS 61.102) notifying employees, as defined in KRS 61.101, of their rights to protection against retaliation for reporting violations to certain authorities. A whistleblower policy should be adopted and distributed to employees. The policy should include reporting procedures and management's responsibility to address issues reported.

7. An internal audit function could be used to ensure that Board concerns are independently investigated. The individual designated to perform internal audits should be given the authority to investigate and examine any area designated by the Board and the responsibility to report the audits findings directly to the Board.
8. A Board audit committee should appoint and compensate the audit firm and ensure the rotation of the lead audit partner and the audit partner reviewing the audit, as required by the Sarbanes Oxley Act (SOX) for companies with publicly traded stock. The Board should also consider whether rotating audit firms would be beneficial given the facts and circumstance of the organization. Further, if possible, the Board audit committee should be comprised of at least one member who has an understanding of generally accepted accounting principles and financial statements, experience with internal controls and in preparing or auditing financial statements, and an understanding of audit committee functions, as suggested in Section 407 of SOX. In addition, reviews of internal controls should be conducted to ensure that controls are functioning as designed or needed. The review of internal controls could be conducted by an internal auditor, Board designee, or included in the engagement of an auditing firm. Any concerns noted by the Board should be disclosed to the auditor and included in the audit scope for review.
9. The Board should adopt a code of ethics that includes standards of conduct for its Board members, officers, and employees related to business conduct, integrity, and ethics. The policy should include the requirement to sign a form stating that the individuals have received and understand the code of ethics. The code should include statements regarding moral and ethical standards, confidentiality, conflicts of interest, nepotism, gifts, honoraria, and assistance with applicable audits and investigations. Violations of the code of ethics should be reported to the Board or designated committee of the Board.
10. The Board should adopt a financial disclosure policy for Board members and executive management. A policy should also be developed requiring Board members and executive management to disclose any conflicts of interests. The disclosure form should be completed by a specified date and returned to the appropriate committee of the Board.
11. The Board should establish and approve a detailed, equitable personnel and compensation policy. The policy should include that the Board or a designated Board committee annually review the salary increases and bonus payments made to all staff. This review should be documented in the Board meeting minutes.

12. The Board should define and document all employee benefits in a fair and equitable manner. Benefits received that result in taxable income should be properly accounted for and accrued to each applicable employee. Employee benefits should also be reviewed to ensure they provide a reasonable business purpose. Also, membership fees to organizations or associations should provide a reasonable business benefit.
13. The Board should approve the compensation package of the organization's primary executive and be aware of the compensation provided to other Executive Staff. In determining the compensation for the primary executive, the Board should consider the organizations financial resources, current economic conditions, employee performance, and salary data for similar positions at relevant organizations within the region.
14. The Board should ensure a well-defined employee evaluation system is implemented within the organization to consistently assess employee performance. The results of the employee's evaluation should be used for employee advancement or salary adjustments.
15. The Board should adopt policies to ensure all forms of employee leave are properly approved and accurately recorded.
16. The Board should have sick and vacation leave policies that address the accrual, use, and the payment to employees for any unused sick, vacation, or compensatory time.
17. The Board policy should include a transparent, competitive selection process for the procurement of goods and services. The policy should outline the circumstances under which quotes or competitive bids are required and the process to be followed. The Board should have policies that require a formal contract for purchases over a specified amount and that all contracts over a specified dollar amount require Board approval.
18. A review of budget to actual expenditures should be performed regularly by the Board or a designated Board Committee to monitor costs in each account. The name and number of budget categories or line items should provide transparency and sufficient detail to allow Board members to accurately identify the types of expenses being attributed to each category. If expenditures occur at an unexpected rate, additional detail should be requested to ensure that incurred expenditures are reasonable and necessary.
19. At least quarterly, the Board or a designated Board committee should receive and review a listing of payments that includes, at a minimum, the payee, dollar amount, and date of each expenditure. This review would assist in identifying inappropriate, unusual, or excessive expenditures.
20. Executive management traveling out of state should present their plans and estimated costs to the Board for prior approval. The approval of these activities and associated costs should be addressed at the Board meetings to ensure proper documentation in the minutes. Subsequent to attending approved conferences or activities, the amount expended should be reported to the Board.

21. To minimize and control the cost of travel, a travel expense policy should be developed that specifically defines the allowable costs related to lodging, meals, entertainment, personal mileage reimbursement, rental cars, and airfare. The travel expense policy should state the invoice requirements for the reimbursement of certain expenditures such as taxi fees, tips, parking, or tolls. The policy should provide examples of expenditures that are to be paid for by the employee, such as costs incurred by family members or the attendance at events not approved by the Board. This policy should explicitly state that expenses not in compliance with the travel expense policy would not be reimbursed or paid by the Board.
22. In lieu of credit cards, the Board should consider the following:
  - The use of purchasing cards that would allow the Board to restrict the types of purchases that can be made on the card based on industry codes. Casinos, specialty retail outlets, and food and beverage establishments are examples of these restrictions. The amount spent on a single purchase can also be restricted through the use of a purchasing card.
  - Reimburse employees personal credit card charges when the use is necessary. Procedures and supporting documentation requirements should be developed to facilitate this type of reimbursement.
23. If the use of credit cards is needed, the Board should implement the following oversight controls:
  - A Board member or committee of the Board should be assigned to review, at a minimum, credit card statements of Executive Staff prior to payment.
  - Credit card charges should be supported by detailed receipts, documented business purpose, and supervisory approval. The employee should be responsible for the timely payment of any unsupported credit card charges or disallowed expenses.
  - Policies established by the Board should ensure that all review procedures are performed in a timely manner to avoid late fee and finance charges.
24. Expenses classified as gifts or entertainment should be documented to include the name and title of the person(s) involved and a description of why the expense was needed and how it relates to business operations.
25. A policy related to reimbursements made by employees to the organization should be developed to ensure that any expenses that should be paid by an employee are monitored. This policy should include the timeframe allowed for making the reimbursement and the alternative actions that will be taken if reimbursement is not made.
26. Business expense reimbursements requested by executive management should be reviewed by the Board or a designated Board committee to ensure supporting documentation is provided. This documentation should be retained to ensure that duplicate payments are not made to the employee.
27. Specific marketing goals should be developed to monitor the success of any business promotions approved by the Board. Marketing expenditures incurred should be coded to that goal so that Board members will know the expenses involved in a specific marketing

promotion. Further, documentation should be maintained detailing the recipients of promotional prizes including tickets, trips, or merchandise.

28. A Board policy should be developed to address the authorization process to purchase vehicles and the method used to dispose of vehicles. The use and assignment of vehicles owned by the organization should be addressed within this policy. In addition, the practice of providing a vehicle should be reviewed and monthly vehicle allowances considered. The policy should include following the IRS guidelines for personal use of a vehicle.
29. The personal use of business equipment should be addressed within Board policy to determine when appropriate. The policy should require that equipment being used inappropriately or that is missing should be reported directly to the Board.
30. The Board should establish a policy detailing the process to report lost or missing financial information or records. To avoid lost or stolen financial information, electronic images of financial records should be created and retained, if possible.
31. A formal policy should be developed that identifies what equipment is a fixed asset and should be included as inventory. Once this designation has been made, the existing inventory listing should include the following identifying information related to each piece of equipment:
  - The name of the individual in receipt of equipment;
  - Description of equipment;
  - Vendor name;
  - Model number;
  - Serial number;
  - Acquisition date; and,
  - Acquisition cost.

Once the inventory listing has been validated, any acquisitions and dispositions of computer equipment that fall within the fixed asset policy should cause an appropriate update to the inventory listing.

32. An information system policy should be developed that explicitly defines a user's responsibilities as they relate to information system resources and applications. These policies should cover, at a minimum:
  - Securing of user id and password;
  - Protection against computer virus or mal-ware infection;
  - Legal notice at logon indicating system is to be used for authorized purposes only;
  - Securing unattended workstations; and,
  - Securing portable devices, such as laptops, Blackberries, cell phones, etc.

**PRESENTATION TO OLDHAM COUNTY WATER DISTRICT  
BOARD OF COMMISSIONERS  
February 13, 2018**

FEB 09 2018

PUBLIC SERVICE  
COMMISSION

**ETHICS: A PRACTICAL EXERCISE**

**Problem 1:** Commissioners Able, Baker, and Charlie of Daniel Boone Water District are holding a joint session with the members of the board of directors of Davey Crockett Water Association to discuss the possibility of joint water construction projects. As they discuss the project, the participants ask their lawyer, Lawyer Dewey of the law firm of Dewey, Cheatem and Howe, if they have the same ethical obligations and if different obligations might affect any joint projects.

**What is the difference between a water association and a water district?**

A water district is "a political subdivision." *Louisville Extension Water District v. Diehl Pumping & Supply Co.*, 246 S.W.2d 586 (Ky. 1952). Water "districts are political subdivisions of county government." *Public Service Comm'n of Kentucky v. Dewitt Water Dist.*, 720 S.W.2d 725, 731 (Ky. 1986). "[A] water district is a type of special district which constitutes a political subdivision of the commonwealth." *Davis v. Powell's Valley Water Dist.*, 920 S.W.2d 75, 78 (Ky. App. 1995). Statutes addressing the operation of water districts, special districts, political subdivisions, and public officials and employees govern.

A water association is a non-profit corporation organized pursuant to KRS Chapter 273. The duties of the members of board of directors of a water association are set forth in KRS Chapter 273.

**What is the position of water district commissioner?**

A water district commissioner is a public officer. *Commonwealth v. Howard*, 379 S.W.2d 475 (Ky. 1964).

**What is the significance of being a public officer?**

Water district commissioners are accountable to the public for their actions. Water association directors are not public officers and, therefore, are not accountable to the public. They are accountable to the members of their association.

A public officer has the following common law duties:

- He owes an undivided duty to the public and must discharge his duties with undivided loyalty. He cannot serve 2 masters.
- He must disclose to the agency information that is pertinent to that agency's operation and that can be communicated without violating a superior duty to another.
- He must perform his duties honestly, in good faith, and diligently.

- He must properly account for all public funds and resources.
- He must follow the law.
- He may not use his official power to further his own interest and is may not place himself in a position result in conflicting duties.

The holder of a public office may not directly, or indirectly, use his office for personal profit. *Buchignani v. Lexington-Fayette Urban County Government*, 632 S.W.2d 465, 467 (Ky. App. 1982).

The following Kentucky statutes regarding official misconduct apply to public officer holders and thus to water district commissioners:

- Local Model Procurement Code (KRS 45A.445 –45A.460)
- KRS 521.020 – Bribery of a Public Servant
- KRS 521.030 – Soliciting Unlawful Compensation
- KRS 521.040 – Unlawful Compensation for Assistance in Public Matters.
- KRS 522.020 - Official Misconduct in the First Degree.
- KRS 522.030 - Official Misconduct in the Second Degree.
- KRS 522.040 - Misuse of Confidential Information.

**What statutes specifically apply to water district commissioners?**

KRS 65.007(1):

Unless otherwise provided by state law, an appointed member of the governing body of a special district may be removed from office by the appointing authority after a hearing with notice as required by KRS Chapter 424 for . . . conflict of interest

KRS 74.020(3):

A commissioner who participates in any official action by the water district board of commissioners which **results in a direct financial benefit** to him may be removed as provided by KRS 65.007 and KRS 74.455.

**What statutes apply to a director of a water association?**

KRS 273.215(1) requires a director to discharge his duties in good faith, on an informed basis and in a manner he honestly believes to be in the best interest of the corporation.

KRS 273.215(2) provides that a director is considered to discharge his duties on an informed basis if he makes, with the care an ordinarily prudent person in a like position would exercise under similar circumstances, inquiry into the business and affairs of the corporations, or into a particular action to be taken or decision to be made.

**What other standards are applied to the officers of a governmental utility?**

KRS 96.533(2) requires a utility commissioner to discharge his duties in good faith, on an informed basis, and in a manner he honestly believes to be in the best interest of the utility board or commission.



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**Problem 2:** Daniel Boone County has enacted a local ethics code to apply to all county elected and appointed officials, not to county employees. The Code specifically prohibits certain types of conduct that Commissioners Able, Baker, and Charlie of the Daniel Boone Water District would like to engage in. They visit Lawyer Dewey for an opinion regarding the applicability of the local ethics code to them.

**Do local ethics codes apply to water district commissioners?**

Yes. With the enactment of House Bill 1 in 2013, officers and employees of a special purpose governmental entity (SPGE), such as a water district, are subject to the local ethics code of the county in which the SPGE's principal business office is located. See KRS 65A.070.

Prior to 2013, local codes of ethics did not apply to special districts such as water districts, but only to city and county governments. *Louisville/Jefferson County Metropolitan Sewer District v. Schardein*, 259 S.W.3d 510 (Ky. App. 2008) (held that metropolitan sewer districts are independent municipal corporations, not agencies of a city within the meaning of KRS 65.003). See also OAG 94-71. Special districts are not precluded from adopting their own codes of ethics. "A special district could adopt relevant portions of a city or county code of ethics or draft a code of its own." OAG 94-71.

Not all provisions of the local ethics code will apply to water district officials and employees. SPGEs are exempted from the requirement to file financial disclosure statements.

**Does the Daniel Boone County ethics code apply to the employees of Daniel Boone Water District?**

Note that the local ethics code only applied to elected and appointed Daniel Boone County officials. The Attorney General has opined that KRS 65.003 requires that local ethics codes apply only to elected officials and that county fiscal courts may, but are not required to, extend their code's coverage to appointed officials and employees. OAG 95-16.

KRS 65A.070(1) provides: "The board, officers, and employees of each special purpose governmental entity shall be subject to the code of ethics of the establishing entity in which the special purpose governmental entity's principal business office is located." It expressly includes employees. Even though Daniel Boone County's code does not apply to Daniel Boone County employees, it probably applies to the employees of Daniel Boone County Water District.

WARNING: To avoid confusion, a water district should make this clear by adopting the local code of ethics and expressly providing that water district employees are covered.

**Does a water district need to adopt the county's ethics code?**

There are conflicting opinions. Some have interpreted KRS 65A.070 to be self-executing. The SPGE, therefore, became subject to the local ethics code when the law became effective. The Department of Libraries and Archives has advised library districts to expressly adopt the local code. Adoption may resolve the problem noted immediately above.

**May a water district adopt its own code of ethics?**

Yes. KRS 65.070 permits an SPGE to adopt a more stringent code. If it does so, the SPGE must file a copy of its code with the Department of Local Government and to the fiscal court of the county in which it is located no later than 21 days after the adoption of the code.

**If a water district wants to establish a more stringent code of ethics, how does it do so?**

- Water district board of commissioners may adopt a resolution establishing standards for its members and employees.
- WARNING: Check the local ethics codes for any conflicts with the water district's personnel policies. Conflicts need to be resolved. If the local ethics code imposes additional or more stringent requirements, then employee education may be necessary to ensure that the water district's employees are trained regarding the ethics code requirements. Failure to provide such training may limit the water district's ability to take action against an employee who fails to comply with the local ethics code.

**If a water district adopts its own code of ethics, how can it enforce its code? Who would hear complaints/investigate alleged violations? What sanctions are available to the water district to impose against violators?**

A water district board of commissioners has no enforcement powers. It cannot impose any sanctions against violators. A violation of an ethics code provision may be considered as "malfeasance in office." KRS 74.455(1) permits the Public Service Commission to remove a water district commissioner for malfeasance in office. It and the Commission's Rules of Procedures also provide the procedures to use for the investigation and hearing on any alleged violation. KRS 74.455 provides no avenue for appeal from a Commission decision.

In lieu of the Public Service Commission, KRS 65.007 permits the appointing authority (County Judge/Executive) to remove an appointed member of the governing body of a special district for "inefficiency, neglect of duty, malfeasance or conflict of interest." As to process, KRS 65.007(1) provides: "The hearing shall be initiated and

chaired by the appointing authority, who shall prepare a written statement setting forth the reasons for removal. The member to be removed shall be notified of his proposed removal and the reasons therefor by registered mail sent to his last known address at least ten (10) days prior to the hearing. The person to be removed may employ counsel to represent him. A record of the hearing shall be made by the appointing authority." The members of fiscal court must approve the removal action. All decisions are appealable to the local Circuit Court.

**What code of ethics applies to members of a water association's board of directors? How is that code enforced?**

Water association may establish a code of ethics through its board of directors. A director's failure to comply with the code would be grounds for removal. The board of directors (or a court) would be the only entity that could remove the director. KRS 74.455(3) permits the Public Service Commission to request the removal of a member of the board of directors, but does not grant the Public Service Commission the authority to remove. A water association's articles of incorporation may provide procedures for the removal of directors.

**Would a city's code of ethics apply to the members of a city utility commission?**

Yes.

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**Problem 3:** It is December and Christmas time is upon the Daniel Boone Water District. At the December meeting of the Board of Commissioners, General Manager Bernie Madoff recommends that all employees be given a Christmas bonus of \$100. Daniel Boone District has no salary/wage compensation policy. The few employment contracts that Daniel Boone District has are silent on the issue of bonuses. The Board approves the recommendation. Manager Madoff then notes that Commissioners Able, Baker, and Charlie have also worked long hours during the past year. Praising their efforts, Madoff recommends a Christmas bonus of \$100 for each commissioner also. Commissioner Able moves to approve the recommendation and Commissioner Baker seconds it. All of the Commissioners vote in favor.

**What problem, if any, results from rewarding the water district's employees with a Christmas bonus of \$100?**

Section 3 of Kentucky Constitution prohibits "grant of exclusive, separate public emoluments or privileges shall be made to any man or set of men, except in consideration of public services." As employees have already been compensated through regular salary, they are receiving a separate public emolument. This issue can be avoided if an incentive program has been adopted by the board and is part of the employees' compensation package. See OAG 62-1.

**Does the water district board of commissioners have the authority to award themselves a Christmas bonus? Is its action lawful?**

No. Awarding a bonus is the same as paying a salary. KRS 74.020(6) provides that the salary is fixed by County Judge/Executive with the approval of fiscal court. Board could not add to that level of compensation. The board's expenditure is unlawful.

Each board member had a direct financial interest in the resolution. KRS 74.020(3) provides that a commissioner who participates in any official action by the water district board of commissioners which **results in a direct financial benefit** to him may be removed as provided by KRS 65.007 and KRS 74.455.

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**Problem 4:** Daniel Boone Water District does not pay its commissioners a salary. Commissioner Able proposes that, in lieu of a salary, the commissioners should be given free water service. His motion is presented to the Board of Commissioners and is adopted by unanimous vote. Free water service represents an annual cost of approximately \$360. KRS 74.020(6) would permit a maximum salary of \$6,000. The Daniel Boone County Fiscal Court is willing to authorize a monthly salary of \$500.

**Do the water district commissioners receive a direct financial benefit as a result of vote? What if the motion applies only to future commissioners, not existing members?**

Water district commissioners will receive a benefit from the vote (free water service). They are directly interested in the outcome of the vote.

KRS 74.020(3) would permit removal from office because of vote.

If vote applied to future commissioners and exempted existing commissioners, the measure would not result in a direct financial benefit to the current commissioners.

**What other policy concerns are involved?**

County Judge/Executive, with the approval of Fiscal Court, establishes annual salary. KRS 74.020(6). Maximum salary level is limited by statute. Board of Commissioners' actions may be viewed as an attempt to circumvent statutory limits. *But see Caldwell County Fiscal Court v. Paris*, 945 S.W.2d 952, 954 (Ky. App. 1997) ("compensation" and "salary" . . . mean the actual salary or fees paid to an officer"). See also *Hardin County Water District No. 1*, Case No. 2001-00211 (Ky. PSC Mar. 1, 2002) (salary limits do not prevent water district from furnishing health insurance coverage to commissioners). Payment of fringe benefit may be included in salary if part of scheme "to raise the salary of a particular official through the subterfuge of paying certain benefits for him not uniformly available to similarly situated officials. *Caldwell County Fiscal Court* at 955.

PSC has a concern that ratepayers are paying for this "free water service" and has consistently rejected requests for free water service. In *Cannonsburg Water District*, Case No. 2008-00220 (Ky. PSC Mar. 10, 2009), the PSC stated the following policy arguments for denying authorization for free water service:

- It circumvented the statutory controls over water district commissioner compensation that are placed in county judge/executives and fiscal courts.
- It has limited value as a recruiting or retention tool.

- It reduces the transparency of a water district's payments to its commissioners.
- It separates water district commissioners from other ratepayers and may undermine public confidence in the water district's governance.

**Change Factual Scenario:** Board votes to include its members into a retirement system or expand insurance coverage for its members.

**Does this make members subject to removal pursuant to KRS 74.020(3)? Do the members have a direct financial interest in the subject matter of the vote?**

Yes.

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**Problem 5:** Commissioner Baker is president of Simon Legree Bank, a local bank. Daniel Boone Water District has a checking account with Simon Legree Bank. The Bank has also purchased refinancing bonds that Daniel Boone Water District issued. When the water district negotiated the sale of the bonds with the bank, Baker did not take part in the negotiations.

**Does a conflict of interest exist?**

KRS 74.020(2) provides that a water district commissioner may be removed from office as provided by KRS 65.007 and KRS 74.455.

KRS 65.007 allows removal for "conflict of interest."

OAG 80-654: No conflict. Depositing funds in a bank where a public official is a director or officer does not constitute a conflict of interest. Refer to *McCloud v. City of Cadiz*, 548 S.W.2d 158, 162 (Ky. App. 1977):

An "interest is not sufficient to disqualify the officer if the opportunity for self-benefit is a mere possibility or is so remote or collateral, such as being only a debtor, that it cannot be reasonably calculated to affect his judgment or conduct in the making of the contract or in its performance."

The interest is considered too speculative or remote. AG holds the same for the purchase of bonds where the water district commissioner did not participate in the negotiations.

**Change Factual Scenario:** The Board of Commissioners has solicited bids for the checking account and/or for the purchase of the refinance bonds and the Board was about to vote to award the contract.

**Does a conflict exist? Will Baker receive a "direct financial benefit" from the award of the contract?**

Using the method of analysis used in OAG 80-654, no conflict exists. Baker receives no direct financial benefit from the award of the contract to the Bank. He is an officer but not an owner of the Bank.

An appearance of conflict does exist. Public impression is created that Baker is attempting to assist his employer by awarding water district business to that employer. Baker should recuse himself, but is not required to recuse himself and does not face the threat of removal if he votes for the award.

**Would it make a difference if Baker was the principal shareholder/owner of the bank?**

**Change Factual Scenario:** Daniel Boone Water District has adopted the Model Local Procurement Code.

### **What is Local Model Procurement Code?**

Model uniform code for procurement of goods and services by local governments. Special districts, such as water districts, are not required to adopt the LMPC, but are permitted and encouraged to adopt.

LMPC provides: "Public employment is a trust." It further provides: "Employees must discharge their duties and responsibilities fairly and impartially. They should also maintain a standard of conduct that will inspire public confidence in the integrity of the government of all local public agencies." KRS 45A.450.

### **What is the effect of LMPC?**

Under the Local Model Procurement Code, a "financial interest" includes "[h]olding a position in a business such as an officer, director, trustee, partner, employee, or the like, or holding any position of management." KRS 45A.445(4)(c). Baker has a conflict of interest and his participation in any decision on the award of either contract would be a "breach of ethical standards." KRS 45A.455(1)(c).

Under the LMPC, Baker could not participate in the transaction. If he participated in the transaction, the LMPC does not expressly void the transaction, but the ethics rules are required to be part of the contract. Therefore, the water district could argue that a breach of contract occurred as a result of the contract and attempt to void the contract. The water district could also seek recovery from Baker anything of value that was received as a result of the breach.

**Change Factual Scenario:** Daniel Boone Water District is a water association.

KRS Chapter 273 applies.

KRS 273.219(1) provides: "A conflict of interest transaction is a transaction with the nonprofit corporation in which a director of such corporation has a direct or indirect interest."

KRS 273.219(2) provides that "a director of a nonprofit corporation shall be considered to have an indirect interest in a transaction if (a) another entity in which he has a material financial interest or general partner is a party to the transaction; or (b) Another entity of which he is a director, officer, or trustee is a party to the transaction and the transaction is, or should be considered by the board of directors of the corporation."

Baker would have an indirect interest in the transaction. A conflict would exist.



**If Baker as a member of the water association board voted on the transaction, would the transaction be voidable?**

Yes unless the material facts of the transaction and Baker's interest were disclosed or known to the board of directors and the board authorized or approved the transaction and the transaction was fair to the corporation. See KRS 273.219. Failure to disclose would constitute possible grounds for the water association to void the contract and for any member of the association to bring an action against Baker to collect damages resulting from the award of the contract.

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**Problem 6:** Daniel Boone Water District is examining its insurance coverage and determines that a new and more comprehensive policy is required. It negotiates with Bobby Baker, Commissioner Baker's son and the only insurance agent in Daniel Boone County. At the conclusion of the negotiations (in which Commissioner Baker did not take part), a contract is presented to the Board of Commissioners for action.

**Does Commissioner Baker have a conflict of interest?**

KRS 74.020(3) provides that a water district commissioner who participates in any official action by the water district board of commissioners that results in a direct financial benefit to him may be removed.

KRS 65.007 allows removal for "conflict of interest."

OAG 80-198: No statutory conflict of interest. Statutory conflict is "confined to a monetary consideration and not include merely an emotional interest that a member of the board might have in the member rendering the service." No monetary benefit to the board member. An indirect conflict of interest, however, exists and the member should refrain from voting on the issue.

**Change Factual Scenario:** Daniel Boone Water District has adopted the Model Local Procurement Code.

KRS 45A.455(1)(a) provides: "It shall be a breach of ethical standards for any employee with procurement authority to participate directly in any proceeding or application; request for ruling or other determination; claim or controversy; or other particular matter pertaining to any contract, or subcontract, and any solicitation or proposal therefor, in which to his knowledge: He, or any member of his immediate family has a financial interest therein . . ."

KRS 45A.455(1)(c) defines immediate family member as "a spouse, children, grandchildren, parents, grandparents, brothers and sisters, and such other relatives as designated by the local public agency."

Under the Local Model Procurement Code, Baker's participation would be breach of ethical standard.

**Change Factual Scenario:** Commissioner Baker, not Bobby Baker, is the owner of the insurance agency. Daniel Boone Water District does not negotiate for coverage, but asks for bids.

### **May Baker submit a bid?**

No statutory provision prohibits a commissioner from submitting bid.

Baker may not participate in the Board of Commissioners' decision regarding bids.

Baker may not use information obtained from his position as commissioner to develop his bid.

Public perception and the appearance of impropriety are important considerations.

Attorney General would argue that any private business dealings between the water district and Commissioner Baker are improper and should be avoided. OAG 66-788: "[T]here is no statute prohibiting commissioners of a water district from contracting with the district; however, we believe that such would create a conflict of interest and be against public policy." AG refers to the common law rule prohibiting public officers from contracting with boards and commissions, of which they are members." Under this opinion, Baker cannot submit a bid or enter into a contract with the water district.

**Change Factual Scenario:** Daniel Boone Water District has adopted the Model Local Procurement Code.

Baker could not participate in any vote to accept his bid nor could he participate as a board member in the procurement process. KRS 45A.455(1)(a) provides: "It shall be a breach of ethical standards for any employee with procurement authority to participate directly in any proceeding or application; request for ruling or other determination; claim or controversy; or other particular matter pertaining to any contract, or subcontract, and any solicitation or proposal therefor, in which to his knowledge: He, or any member of his immediate family has a financial interest therein . . ."

**Problem 7:** Commissioner Able is a real estate agent with a client who has a parcel of property near a water district structure. At several board meetings and in private conversations with other board members, Able proposes to his fellow commissioners that the water district purchase this parcel. The board agrees and executes a contract for the purchase. Able's agency contract with the seller provides for a five percent commission on the purchase price. He expressly declines the commission, but arranges for the seller to donate an amount equal to the declined commission to a local charitable organization of which he is the chairman. Able did not vote on the resolution to purchase the parcel nor did he disclose his relationship to the board.

### **Does Commissioner Able have conflicting interests?**

Yes. As the real estate agent, he has a duty to serve his client and to obtain the sale of the client's property at the highest price possible. He should advocate the sale regardless of whether the purchase of the property benefits the purchaser. As a commissioner, he has a duty to obtain any needed property at the lowest cost and to consider less costly alternatives.

**Does Commissioner Able have a direct interest in the property purchase?**

Able has a direct interest in making the sale. He will earn a commission on the sale of the property. This interest still exists even though he has the commission donated to charity. Able controls where the donation is made and has an interest in the charity as he is its chairman.

**Did Commissioner Able's abstention from voting on the proposed sale sufficient to absolve him of any improper conduct?**

No. If he participated in discussions on the purchase of the property before the board, then he participated in official action.

**What common law duties did Commissioner Able's conduct violate?**

- Undivided loyalty to the public
- Duty to disclose information to the agency that is pertinent to the operation of water district
- Duty not to use his office for personal profit

Public perception and the appearance of impropriety are also important considerations.

**Change Factual Scenario:** Assume that Able disclosed his role as real estate agent for the property owner.

**Does disclosure render Able's conduct within acceptable standards? Why? Why not?**

**Change Factual Scenario:** Daniel Boone Water District has adopted the Model Local Procurement Code. No disclosure of Able's role.

**Does Able's conduct constitute a breach of ethical standards? Why or why not?**

Yes. KRS 45A.455(1)(a) provides: "It shall be a breach of ethical standards for any employee with procurement authority to participate directly in any proceeding or application; request for ruling or other determination; claim or controversy; or other particular matter pertaining to any contract, or subcontract, and any solicitation or proposal therefor, in which to his knowledge: He, or any member of his immediate family has a financial interest therein . . ."

**What, if anything, happens to Able?**

KRS 45A.460 permits water district to bring an action against Able for recovery of the five percent agent's fee.

**Change Factual Scenario:** Daniel Boone County Water District is now a water association.

It is a conflict of interest transaction. KRS 273.291(1) provides: "A conflict of interest transaction is a transaction with the nonprofit corporation in which a director of such corporation has a direct or indirect interest." Able has a direct interest in the transaction. The transaction is voidable if it is not fair to the water association. The water association may have an action at common law to recover the five percent fee.

If Able discloses his involvement with the transaction at the outset to the water association's board of directors, then the transaction is not voidable.

**Assuming full disclosure to the board of commissioners, is appropriate May Commissioner Able advocate for a client before the board of commissioners?**

No. Able still is failing to maintain undivided loyalty to the water district and the appearance of impropriety remains.

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**Problem 8:** Daniel Boone Water District has an opening for a new meter reader. Commissioner Able urges the water district's general manager to hire his son. Able's son is an excellent worker and has good references from other employers.

**Is the recommendation "nepotism"?**

Nepotism is generally defined as "bestowal of patronage by public officers in appointing others to offices or positions by reason of their blood or marital relationship to the appointing authority, rather than because of the merit or ability of the appointee." Recommendation does not involve official action. There is no appointment. No nepotism involved.

**What's wrong with nepotism?**

Appearance of impropriety. Family relationship appears to be the critical factor in selection rather than the ability of the prospective employee. Nepotism raises doubts about agency's operations. Is agency being operated for the public's benefit?

**Change Factual Scenario:** Able threatens the general manager with retaliation if the son is not selected

- KRS 522.020 - Official misconduct in the first degree.
- KRS 522.030 - Official misconduct in the second degree.
- Malfeasance/Abuse of Office (grounds for removal by Public Service Commission under KRS 74.455 and by County Judge/Executive under KRS 65.007.)

**Change Factual Scenario:** Daniel Boone Water District's general manager interviews Able's son and selects him for the job. No vote of commissioners is taken, but Able had previously voted to give complete authority to the general manager to hire employees.

**May Daniel Boone Water District hire Able's son?**

OAG 82-373: "[T]here are no common law prohibitions against a board hiring as an employee someone related to a board member. Neither are there any constitutional or general statutory prohibitions to a board hiring a relative of a board member as an employee. Therefore, unless a specific statutory prohibition exists, such employment would not create a conflict of interest." (Addressing the question of whether a library board may hire a relative of a member of library board).

No statutory prohibition against nepotism by water district officials. There is no general law against nepotism in Kentucky. See OAG 78-239 (County Attorney hiring his wife to perform secretarial duties.)

Local ethics code generally forbids nepotism.

**Does the hiring of Able's son constitute a violation of any ethics law on Able's part?**

No violation. Able has taken no action in the matter. WARNING: If local ethics law prohibits nepotism and the hiring falls within the definition of nepotism in local code, then hiring violates local ethics code. Failure to comply with local ethics code may be grounds for removal from office or prosecution for failure to comply with ethics code.

See *Chadwell v. Commonwealth*, 157 S.W.2d 280 (Ky. 1941) (held that a board of education member's vote to authorize the School Superintendent to hire bus drivers without the board's approval and subsequent hiring of the member's daughter was insufficient for finding that member voted on a matter in which he was directly interested).

**Change Factual Scenario:** Daniel Boone Water District's general manager interviews Able's son and selects him for the job. The general manager presents the issue to the Daniel Boone Water District Board of Commissioners for a vote.

**May Able vote on his son's hiring?**

KRS 74.020(4) permits the removal of a commissioner who participates in any official action that results in a **direct financial benefit** to him.

Does the hiring of son result in a direct financial benefit to Able? AG addressed the issue in OAG 91-110 and concluded that county judge/executive is not "directly interested" in a contract of employment between his wife and county.

While Able may vote, voting creates the appearance of impropriety. Able should recuse himself.

**Assume that the vote would have represented a direct financial benefit to Able, what must he do to recuse himself?**

Abstention is not sufficient. "When a quorum of a governing body is present those members who are present and do not vote will be considered as acquiescing with the majority." *Pierson-Trapp Co. v. Knippenberg*, 387 S.W.2d 587 (Ky. 1965). See also *Hunters Ridge Homeowners Assn v. Hicks*, 818 S.W.2d 623 (Ky.App. 1991).

OAG 88-35: "[T]he rule is that a member who passes, or does not vote, acquiesces with the majority. Thus, the possibility exists when the member with the conflict abstains or refuses to vote, that abstention results in the third vote required for board action. KRS 160.270(1). In that instance, the effect of the abstention is no

different than an affirmative vote. Therefore, in order to prevent the problematic circumstance, the member with the conflict should be absent either from the entire meeting or from the discussion and the vote on the issue in which he or she has the conflict.”

Other recommended actions:

- A commissioner/director should notify the other board members in writing in advance that he/she will not participate in the decision and will not be present when the action is discussed and a vote taken.
- The commissioner/director should leave the room when debate and voting on the action in question is conducted.
- The commissioner/director should refrain from discussing the action with any board member at all times. He/she should avoid the appearance of lobbying or otherwise influencing other board members.



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**Problem 9:** Commissioner Able owns property that is located within Daniel Boone Water District's territory, but does not presently receive water service. Able applies to the water district for water service. The requested service will not require a deviation from existing water district rules or regulations. The Board of Commissioners is not required to take any action on his application. The provision of water service to the property will increase the value of the property.

**May Able make such application?**

Yes. He is not prohibited from requesting service or otherwise dealing with water district in a private capacity in some instances. He is not providing any service to the water district nor is the water district contracting to purchase services. Able is not receiving any benefit by virtue of the office that he holds. He is seeking a service that is available to all persons residing within the water district's territory.

**Change Factual Scenario:** Commissioner Able's request for water service requires a deviation from Daniel Boone Water District's Rules and Regulations. The Board of Commissioners must vote on the request for a deviation.

**May water district commissioner make a request for action that will benefit him while serving as commissioner?**

A direct financial benefit results to Able if the request is granted. If he votes on the request, he may be removed from office. KRS 74.020(4).

No statute prohibits him for making request. Other persons within the water district have the right to request deviation of rules. He does not surrender that right by becoming a water district commissioner. He may not, however, use his office to advance his request.

Able should avoid lobbying or privately discussing the proposed request with the board members to avoid any appearance of impropriety. He should not participate in the discussion or vote on the requested

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**ETHICS: A PRACTICAL EXERCISE**

**Problem 10:** Daniel Boone Water District has several pieces of heavy construction equipment used to install, repair, and maintain facilities. Able directs the water district's general manager to provide him access to equipment on the weekends. Able uses the equipment to make improvements upon his property. Equipment is returned to water district before start of business week. Water district does not incur any loss of time by the transaction.

**May a commissioner use water district equipment for a private benefit?**

Able receives a direct benefit from use of the equipment. He is clearly avoiding the cost of renting similar equipment. The equipment is not intended for personal or private use. He is receiving the use of that equipment solely as a result of his official position.

Able is violating his common law duty as public officer. He has a duty to properly account for the use of district equipment. He is subject to suit for amount equal to rental value of equipment.

Able has violated KRS 522.020 and KRS 522.030 and may be subject to prosecution.

Water district may need a policy on use of equipment by its officers and employees.

See Auditor of Public Accounts, *Recommendations for Public and Nonprofit Boards* (Mar. 4, 2010), Recommendation No. 29 ("The personal use of business equipment should be addressed within Board policy to determine when appropriate. The policy should require that equipment being used inappropriately or that is missing should be reported directly to the Board. ")

**Change Factual Scenario:** Daniel Boone Water District has a written policy that permits employees and officials to use equipment during non-work hours. Policy requires the payment of rental fees, proof of insurance coverage on equipment, and indemnification agreement.

**Does the initiation of policy resolve improper use questions?**

Establishment of written policy eliminates some issues related to abuse of office or official misconduct.

A rental payment ends question of improper benefits. No monetary benefit will accrue to Able.

Public perception may exist that water district equipment is being used for private purposes.

**Change Factual Scenario:** Able uses water district office equipment to prepare private letters or assist local church or social group of which he is a member. He uses equipment only during non-business hours and makes all efforts to ensure that his use does not interfere with any water district activity or operation. His use is infrequent.

**Is the level of the use or the lack of interference in water district operations of significance?**

Not in a legal sense. Able still receives a direct benefit from use of the equipment. The equipment is not intended for personal or private use. He is receiving the use of that equipment solely as a result of his official position with water district. Able has violated KRS 522.020 and KRS 522.030 and may be subject to prosecution.

Able's activities, however, are *de minimis*. They represent a commonly recurring problem throughout government and business. Use of facilities on this type of basis may be seen as a benefit to employees and officers and encourage morale and job satisfaction. Federal government's rules of ethics permit use of government office equipment for personal non-business activities if supervisor approves, work is done during non-duty hours and does not interfere with official business.

The water district should adopt an official policy on office equipment use. See Auditor of Public Accounts, *Recommendations for Public and Nonprofit Boards* (Mar. 4, 2010), Recommendation No. 29. Policy could permit *de minimis* use under certain circumstances or prohibit any use.

**Change Factual Scenario:** Able directs Daniel Boone Water District's general manager of water district employees to make improvements upon his property during work hours and using water district equipment.

Able receives a direct benefit from activities.

Able has violated KRS 522.020 and KRS 522.030 and may be subject to prosecution.

Action can be brought against Able to recover the value of the benefits to his property and the costs to the water district.

Able may be removed from office for malfeasance and abuse of office. KRS 74.455.

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**ETHICS: A PRACTICAL EXERCISE**

**Problem 11:** Commissioner Able is a retired attorney who has some experience constructing and installing water mains. Daniel Boone Water District is about to begin a new water distribution main expansion project. Its engineering firm proposes to assess a fee of \$27,000 for inspection services to ensure that the construction firm properly installs the water distribution main. Able proposes that Daniel Boone Water District enter a personal services contract with him for the inspection services. Able will perform the services for no more than \$7,500. He argues, and the Board of Commissioners agrees, that he is as competent as the last inspector that the engineering firm retained and will proceed with the water district's best interest always in mind. Daniel Boone Water District's Board of Commissioners votes to offer the contract. Commissioner Able is currently paid a salary of \$6,000.

**May Able contract to provide inspector services to the water district?**

There is no expressed statutory prohibition against a commissioner providing contract services to a water district.

OAG 66-788: "[T]here is no statute prohibiting commissioners of a water district from contracting with the district; however, we believe that such would create a conflict of interest and be against public policy." AG refers to the common law rule prohibiting public officers from contracting with boards and commissions, of which they are members." Under this opinion, Able cannot submit a bid or enter into a contract with the water district.

**May Able vote on the contract?**

No prohibition is found in KRS Chapter 74. The matter will result in a direct financial benefit to Able. Therefore, if he votes on the matter, Able is subject to removal. KRS 74.020(3).

If Daniel Boone District has adopted the Local Model Procurement Code Able's participation in decision process is a breach of ethics. KRS 45A.455(1).

Common Law principles prohibit self-dealing. Public officer is not permitted to benefit from his office. To the extent that Able is voting to award himself a contract, he is benefitting from his office.

**Assume that the water district was a water association.**

The transaction would clearly be a "conflict of interest transaction." Able has a direct financial interest in the transaction. The transaction would not be voidable, however, since Able's interest in the contract is self-apparent and has been disclosed to the board of directors.

**May Able accept compensation for the services if he is already receiving an annual salary of \$6,000?**

Conflicting authorities. OAG 95-31: "Public officials may receive payment in excess of the constitutional salary maximum for services that have no affinity or connection with official duties. . . . [Contracts for services] are valid only if 1) the services are personally performed by the officer who receives compensation; 2) the compensation is reasonable in amount; and 3) the officer is not required by law to perform the services." See also *Land v. Lewis*, 186 S.W.2d 806 (Ky. 1945).

Addressing the same scenario, the Public Service Commission found in *Horn v. Estill County Water District No. 1*, Case No. 91-032 (Ky. PSC May 11, 1992), that such an arrangement would be unlawful, but in *Southern Madison Water District*, Case No. 2006-00465 (Ky. PSC Feb. 15, 2008) found that the arrangement was proper.

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**ETHICS: A PRACTICAL EXERCISE**

**Problem 12:** Daniel Boone Water District needs to make major system improvements, including the construction of large transmission and distribution mains, to improve service and meet expected future demands. The water district's general manager, engineers, and a member of its Board of Commissioners have extensively studied various options for the route of transmission and distribution mains. The best route is a route that runs in part over the property of Commissioner Able. Able did not participate in any of the planning discussions. If the route is selected and the new facilities are built, the value of Able's property will increase significantly.

**Is there any prohibition against the water district selecting a route that runs through Able's property?**

No statute prohibits a water district from transacting business with an employee or officer. A potential appearance of impropriety, however, exists. Unless the water district condemns Able's property, the water district must enter into a purchase agreement with Able. It thus appears to contradict the common law principle that a public official should not contract with his agency.

**May Able vote on the proposed route when the project is presented to the Board of Commissioners?**

No. Water district's selection of the proposed route is official action in which Able will receive a direct financial benefit. If he votes on the proposal, he may be removed.

Able's vote on the matter will also create the appearance of impropriety.

Able should recuse himself and state the reasons for his recusal.

**May Able participate in the discussion on the proposed route or lobby other members on the proposal?**

No statutory prohibition against discussing the proposal at the Board's meeting or urging members to vote for the proposal. Such action creates the appearance of impropriety.

**Change Factual Scenario:** The other members of the Board of Commissioners and the water district's employees are unaware of Able's interest in the property. (ABC Corporation owns the property. Able is the principal stockholder of ABC, but is not listed as an officer on any state records.)

**Does Commissioner Able have an obligation to disclose his interest to the board?**

No specific statutory requirement of disclosure.

Common law duty to give undivided loyalty to water district and to disclose a potential conflict of interest to the water district. Failure to disclose such information may subject Able to action for breach of his fiduciary duty to the water district and require him to disgorge any profits resulting from the transaction.

Common Sense Problem: Selection of route (assuming Able did not vote) will still have some repercussions. Public may have doubt about the true reasons for selection. The Board needs to know that these repercussions exist.

**Change Factual Scenario:** Daniel Boone Water District is a water association and Able was a member of the board of directors.

KRS 273.219 is applicable. Able has a direct interest in the transaction. He will profit by the sale of the property. The transaction is a conflict of interest transaction. If he fails to disclose his interest, the transaction is voidable unless it is fair to the water association.

**Change Factual Scenario:** Able participated in the planning process. He was aware of certain conditions on his property that would render the route unusable or at least increase the cost of installing the mains. This increased cost would likely lead to the planning group recommending an alternative route. The problems were not readily known to the planning group or any other member of the public. Able did not reveal these problems to the planning group or to the Board.

**What duty, if any, does Able have to disclose the problems to the planning group or to the Board?**

Able has a fiduciary relationship with the water district.

- He has a common law duty to disclose information that is pertinent to the transaction.
- He has a duty to disclosure his interest in the project to the board.

Failure to disclosure condition of property may constitute a violation of KRS 522.020 and KRS 522.030.

**Change Factual Scenario:** Able participated in the planning process, but he does not own the property in question. After learning that the property may be the site of many of the facilities, he quickly purchases the property at a very low price with the intent to sell to the water district at a much higher sales price.

**What use may a water district commissioner make of information that is disclosed to him in his capacity as commissioner and which is not generally known to the public?**

Common law standard: Able has a duty of undivided loyalty to the water district. He also has a fiduciary relationship with the water district. He may not personally profit from information that he has gained through his position as commissioner.

If Able carries out his plan, the water district may bring an action for breach of fiduciary duty against Able to recover any profits that Able earned as a result of his purchase and resale of the property. The profits are deemed to belong to the water district.

Able has violated KRS 522.040 - Misuse of Confidential Information. "A public servant is guilty of misuse of confidential information when, in contemplation of official action by himself or by a governmental unit with which he is associated, or in reliance on information to which he has access in his official capacity and which has not been made public, he accepts or agrees to accept a pecuniary interest in any property, transaction, or enterprise which may be affected by such information or official action; or speculates or wagers on the basis of such information or official information, or aids another to do any of the foregoing."



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**ETHICS: A PRACTICAL EXERCISE**

**Problem 13:** The Daniel Boone Water District is a proud member of the Daniel Boone Chamber of Commerce. The chamber has played a significant role in economic development for Daniel Boone County. Its efforts have attracted several new commercial and industrial firms to Daniel Boone County. These firms are large water users. Their addition to the water district's system has ensured the water district's financial viability and is a key factor in allowing the water district to expand to unserved parts of the water district's territory. The Chamber is conducting a fund-raising campaign to fund its economic development efforts. The chairman of the Chamber's fundraising drive appears at the water district's board meeting to request a contribution. Able, who is the Chamber's executive director, moves that the water district provide financial support in the form of contribution of \$5,000.

**May the Commissioners make a donation of water district funds to the Chamber of Commerce?**

Arguments In Favor:

- Greater economic development will increase use of water district's facilities, spread cost over a greater customer base, and therefore will decrease average cost per customer.
- Consistent with water district's economic development mission.
- Chapter 74 does not expressly prohibit.

Arguments Against:

- Chapter 74 makes no mention of an economic development mission for water districts.
- OAG 92-43: "In our view, a donation of water district funds, by a water district created pursuant to KRS Chapter 74, "to civic organizations such as the chamber of commerce or an independent non-profit organization formed for the purpose of attracting business and industry to the county in which the water district operates," would involve an expenditure inconsistent with the statutory purpose of a water district, and thus cannot be lawfully made. As a creature of statute, a water district created pursuant to KRS Chapter 74 may expend funds only in keeping with its statutory authorization. A review of KRS Chapter 74 does not reveal an authorization for a donation of the type you have asked about by a water district created pursuant to that chapter."
- Unpublished AG Opinion to Warren County Water District- Letter from David E. Spenard, Assistant Attorney General, to Frank Hampton Moore, Jr., counsel for Warren County Water District (Jan. 2, 2007).

**What is the liability of the water district commissioners if they make the donation?**

A public official who makes an unlawful disbursement of public funds is liable to the government for the funds and an action may be brought against him to recover those funds. *City of Princeton v. Baker*, 35 S.W.2d 524 (Ky. 1931).

1956 OAG 36,219: "The water services rendered to each citizen constitutes a public function, and the amount of the fee charged to each citizen is in the nature of a tax necessary to pay the expense of the governmental function of serving water to such citizen. To expend any part of the funds arising from fees for water services for any purpose other than those for which the district was created is to contravene the provisions contained in sections 171 and 180, State Constitution, and to do so, is illegal. The officer making such illegal expenditure subjects himself to the obligation upon the demand of any citizen who pays fees for water services to either recover from the person to whom the illegal sum was donated or to reimburse the district for the amount of the illegal donation."

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**ETHICS: A PRACTICAL EXERCISE**

**Problem 14:** Daniel Boone County Judge Executive Boss Hogg recently appointed Commissioner Charlie to the Daniel Boone Water District's Board of Commissioners. The water district's territory covers all of Daniel Boone County with the exception of Mingo City. Its territory encompasses about 88 percent of Daniel Boone County. Approximately 90 percent of Daniel Boone County's population is within the water district's territory. The water district, however, currently only serves about 30 percent of the County's population. Charlie and several members of his extended family live in an area that does not currently receive water service. Charlie proposes that the water district engage in an extensive expansion campaign to build water mains and provide service to the unserved areas of Daniel Boone County. Among the first areas to which he proposes to extend service is the area where he and several family members live. He develops and presents to the Board of Commissioners a comprehensive proposal, which includes the issuance of revenue bonds, to construct the extension that includes his home.

**May Charlie serve as a commissioner since he is not a customer of Daniel Boone Water District?**

Yes. KRS 74.020(1) only requires that a person reside in a water district's territory.

**Does Commissioner Charlie have a direct financial interest in the proposed project?**

No direct financial interest: Commission Charlie has no financial interest in the construction of the line. He receives no money from the award of the contract. There is no evidence that he has a monetary interest in the construction of the water main or the issuance of the revenue bonds. While he will receive service once the water main is constructed, the interest is not direct. He receives a benefit from the construction of the water main, but only as a resident of the geographical area that is benefitting from the water main. Note the comment of the Judge Executive in Exhibit EE who stated that he appoints residents from unserved areas as commissioners because they have an incentive to work to expand service to their neighbors and better know the detriments of lacking water service.

Direct financial interest: Though he will not receive any monies from the award of the construction contract or the issuance of the bonds, he benefits from the construction of the water main. The availability of water service to his property will increase the value of his property and make it more marketable.

**May Commissioner Charlie participate in the vote on the proposal? Should he?**

Unless Commissioner Charlie has a direct financial interest in a matter before the Board, there is no legal restriction to his participation in the vote. If his interest in

obtaining water for his property is deemed to be a direct financial interest, then his participation in the vote would be grounds for removal under KRS 74.020(3). If deemed a conflict of interest, he could be removed under KRS 65.007. Is it a conflict of interest if Commissioner Charlie is merely voicing the concerns of the residents of the water district's territory that live in an unserved area?

**Assume that County Judge Executive Hogg selected Charlie because he lived in an unserved area and would more aggressive advocate for the unserved areas.**

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**ETHICS: A PRACTICAL EXERCISE**

**Problem 15:** The following item recently appeared in the Mingo City *News-Times*:

American flags were flying and the big tents were up to welcome the customers of Daniel Boone Water District's Customer Appreciation Day last Friday on the front lawn of the utility's office in Mingo City. The patriotic red, white and blue décor bring on the warm summer days as the water district honors its customers. Hundreds of water customers joined in to help Daniel Boone Water District celebrate its 75 years of service.

After an early morning thunder shower, the weather was perfect for a fun-filled day for all attendees. The grill was hot with the all-time favorite Nathan's hot dogs and the fixings being served. And to top off the nice lunch, customers also enjoyed everyone's favorite deliciously refreshing Erhler's Dairy Ice Cream.

Terry Meiners was on site with WHAS Radio for a live radio remote as customers spinned the birthday wheel and the children received coloring books and crayons. Many vendors were on hand including Davey Crockett University Cooperative Extension Agency, and the Boone State National Guard who provided children with toy helicopters. The Mingo City Fire Department had the big red fire truck on-site for children to climb up in and have their pictures made. Others joining in and providing valuable information for customers as well as give-aways were Dr. Kildare Hospital, International Brotherhood of Electrical Workers Local 3695, and the Alfred G. Packer Deli and Food Emporium. Customers attending received a limited edition Daniel Boone Water 75th anniversary limited edition tee shirt.

The water district commissioners and employees proudly unveiled their new water treatment plant.

Daniel Boone's Chairman of the Board welcomed everyone and Commissioner I.M. Able gave a brief summary of the water district's history. Guest Speaker Maynard T. Krebs with Boone State Rural Water was the guest speaker showing his association's support and singing the water district's praises. He noted that the water district had just

won BSRA's Leaking Pipe Award for Outstanding Water System Management.

After the presentation, Daniel Boone District announced door prize winners, who include: Hazel Nut, Robyn Banks, Doug Graves, and Ted E. Baer. The winner of the \$100 water bill credit was Penny Wise. Daniel Boone District also recognized Stu Pitt, the recipient of the water district's annual \$2,500 college scholarship, which is awarded to the graduating Mingo City High School senior with the highest grade point average.

Daniel Boone District Commissioners I.M. Able, Chris P. Bacon, and Jack Pot and the water district's management extend a big thank you to all who attended the celebration and invite customers unable to attend the event to stop by the office to pick up a free limited edition tee shirt, while supplies last. Customer Appreciation Day is the one day a year that Daniel Boone District sets aside for its customers to show how much the water and its employees genuinely appreciate serving them.

**Is it appropriate to expend funds for a "Customer Appreciation Day"? Which, if any of the items listed below inappropriate? Why?**

**Hot dogs and fixins**

**Door Prizes**

**\$100 Water Bill Credit**

**Tee Shirt**

**May the water district use water district funds to provide a college scholarship to someone residing within its territory?**