



Kentucky Rural Water Association

Helping water and wastewater utilities help themselves

November 9, 2016

RECEIVED

NOV 14 2016

Public Service
Commission

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

Re: Case No. 2016-00322

Dear Ms. Mathews:

Kentucky Rural Water Association (KRWA) held a seminar on October 25, 2016, in Bowling Green, Kentucky, entitled **Utility Law Seminar – 2016 Water Law Series**. On behalf of Kentucky Rural Water Association, I hereby attest that this session, herein referenced as Case No. 2016-00322, was held as scheduled. The planned course of instruction, approved for six (6) credit hours by the Commission, was performed as submitted.

As required, KRWA has included a list of commissioners who attended the class and earned continuing education credit for the approved topics. KRWA did not submit this training for operator continuing education credit; however, the firm of Stoll Keenon Ogden submitted this seminar to the Kentucky Bar Association for continuing legal education accreditation. Along with CLE Program Information we have included the printed information provided to all attendees.

Kentucky Rural Water Association would like to thank the Kentucky Public Service Commission and staff for their leadership and support in approving the training offered during this seminar.

Sincerely,

Janet Cole
Education Coordinator
j.cole@krwa.org

Enclosures (3)

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**Hours Earned by Water District Commissioners Attending the
Utility Law Seminar held October 25, 2016**

NOV 14 2016

**Sponsored by
Kentucky Rural Water Association
Case #2016-00322**

Public Service
Commission

Utility Law Seminar - 2016 Water Law Series			
October 25, 2016			
Holiday Inn University Plaza/Sloan Convention Center			
Bowling Green, Kentucky			
Organization	First Name	Last Name	PSC Hours
Oldham Co. Water District	Jay	Hall	6
Oldham Co. Water District	Mel	Milburn	6

Kentucky Rural Water Association

CLE Program Information

2016 Utility Leadership Inst. - Utility Law Seminar

Program Details:

Date: Oct-25-2016
Location: Bowling Green KY
Total Credits: 6.25
Ethics Credits: 0
Length (Minutes): 380
Subject Codes: env
Activity Code: 171042

Sponsor's Information:

Stoll Keenon Ogden - Lexington
300 W. Vine St., Ste. 2100
Lexington KY 40507

Phone: (606) 231-3000

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[Back](#)

v2.1



2016 WATER LAW SERIES

October 25, 2016

Holiday Inn University Plaza | Sloan Convention Center
Bowling Green, Kentucky

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Public Service
Commission

MORNING AGENDA

7:45 – 8:25 **Registration & Refreshments**

8:25 – 8:30 **Welcome**

8:30 – 9:30 **Utility Litigation Update | Presenters: Damon Talley & Gerald Wuetcher**

Explore recent court decisions involving public and municipal utilities. Discover courses of action to mitigate their effect on utility operations. Review recent decisions addressing a local government's authority to assess a tax to support 9-1-1 emergency services, the likely effect on local governments' efforts to tax water service to support 9-1-1 services, and possible water utility responses. Learn how to properly bill and collect any imposed fees to avoid regulatory problems. Gain insight into recent litigation between public and municipal utilities before the Public Service Commission and lessons to be learned.

9:30 – 9:40 **BREAK**

9:40 – 10:40 **Basics of Bond Finance | Presenter: Mark S. Franklin**

Examine methods of financing water improvements available to cities and water districts, the implications of tax-exempt financing, and the requirements for various financing methods, including their advantages and disadvantages.

10:40 – 10:50 **BREAK**

10:50 – 11:30 **Clean Water Rule: Definition of Waters of the United States | Presenter: LaJuana S. Wilcher**

Recently, the U.S. Environmental Protection Agency promulgated a Rule defining the scope of waters protected by the Clean Water Act. Gain insight into the Rule's potential effects on water and wastewater utilities, prior EPA efforts to develop the Rule, and litigation that the Rule has spawned.

11:30 – 12:10 **Clean Air Act – Risk Management Program Rule & Water Utilities | Presenter: Sarah P. Jarboe**

Gain insight into the U.S. Environmental Protection Agency's Risk Management Program Rule, which addresses chemical accident prevention at facilities that use certain hazardous substances, and learn the Rule's potential impacts on water and wastewater utilities.

PRESENTED BY:





2016 WATER LAW SERIES

October 25, 2016

Holiday Inn University Plaza | Sloan Convention Center
Bowling Green, Kentucky

AFTERNOON AGENDA

12:10 – 1:10 LUNCH

1:10 – 2:10 **EEO No! An Employment Law Update | Presenter: Stacy Miller**

It's been said that the best defense is a good offense. This is especially true in employment law. This session surveys recent developments in employment law—including new U.S. Department of Labor overtime regulations—and explores how to manage your personnel decisions to stay in compliance.

2:10 – 2:20 BREAK

2:20 – 3:20 **Accounting and Auditing Issues for Water Utilities | Presenter: Brian S. Woosley, CPA**

Review current issues that water utilities encounter through accounting for transactions and the audit process. Gain insight into auditor selection, management and board responsibilities, the fraud triangle, preparing for and undergoing an audit, and current GASB statements (including statement 68, which significantly changed accounting for pension obligations).

3:20 – 3:30 BREAK

3:30 – 4:30 **Recent Developments in Utility Regulation | Presenters: Damon Talley & Gerald Wuetcher**

Survey new developments in public utility law and regulation. Changes in Kentucky statutes and laws enacted by the 2016 General Assembly affecting the operation of water utilities will also be discussed. Learn more about recent court decisions and significant Public Service Commission decisions since January 1, 2015 and possible trends. Presenters will share an analysis of recent municipal utility rate proceedings at the PSC.

4:30 Closing Remarks/Announcements

PRESENTED BY:



1

About the Speakers

2

Utility Litigation Update
Damon Talley
Gerald Wuetcher

3

Basics of Bond Finance
Mark S. Franklin

4

**Clean Water Rule: Definition
of Waters of the United States**
LaJuana S. Wilcher

5

**Clean Air Act – Risk
Management Program Rule
& Water Utilities**
Sarah P. Jarboe

6

**EEO No! An Employment Law
Update**
Stacy Miller

7

**Accounting and Auditing
Issues for Water Utilities**
Brian S. Woosley, CPA

8

**Recent Developments in
Utility Regulation**
Damon Talley
Gerald Wuetcher

Mark S. Franklin is an attorney in Stoll Keenon Ogden's Public Finance, Business Services, Mergers & Acquisitions and Real Estate practices. He has served as bond counsel for cities and water districts regarding tax exempt loans with the USDA Rural Development as well as counsel to issuing agencies, including governmental financings with Kentucky nonprofit institutions. Mark is AV Preeminent® Peer Review Rated™ by Martindale-Hubbell® and recognized as a Top Lawyer by Louisville Magazine. He is a member of the National Association of Bond Lawyers and The ESOP Association.

Sarah P. Jarboe is an associate attorney with English, Lucas, Priest & Owsley, focusing her practice on Environmental Law and Civil Litigation. Prior to joining the firm, Sarah served as a law clerk for the Honorable John Minton, Chief Justice of the Kentucky Supreme Court. Since 2010, she has served as Vice Chair of the American Bar Association's Newsletter, Smart Growth and Green Building Committee.

Stacy Miller is a member of Stoll Keenon Ogden's Labor, Employment & Employee Benefits practice. Stacy concentrates her practice on counseling, civil litigation and administrative defense with emphasis on employee benefits, the Family and Medical Leave Act, the Civil Rights Act of 1964, the Americans with Disabilities Act, the Age Discrimination in Employment Act, the Fair Labor Standards Act, the Kentucky Civil Rights Act, Wrongful Termination and Noncompetition and other Employment Agreements.

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.

LaJuana S. Wilcher is a nationally known environmental attorney who has served in top-level environmental policy positions in federal and state government. Throughout her career and currently as a partner with English, Lucas, Priest & Owsley, LaJuana has amassed unparalleled knowledge and experience representing clients before environmental administrative agencies and courts throughout the country. From 1989 to 1993, LaJuana served as the nation's senior regulatory official for water programs at the U.S. Environmental Protection Agency, leading the EPA's involvement in the Exxon Valdez oil spill litigation negotiations and was instrumental in launching EPA's watershed protection approach and Clean Water Act section 319 nonpoint source grant program, and in major policy decisions involving federal drinking water, wetlands and stormwater requirements and permitting. LaJuana also served as secretary of Kentucky's Environmental and Public Protection Cabinet from 2003 to 2006. In addition to her current practice at ELPO, LaJuana is an adjunct faculty professor at Vanderbilt School of Law.

Brian S. Woosley, CPA, is director of audits and quality control with Stiles, Carter & Associates where he also is involved in preparing financial statements and tax returns. His specialty is governmental accounting and auditing with a focus on school districts and city and county governments. Brian is a graduate of Western Kentucky University with a bachelor's degree in accounting and a Master of Professional Accountancy. He serves as an instructor at the University of Kentucky School of Financial Management Institute and conducts numerous training sessions for school districts.

Gerald Wuetcher is a member of Stoll Keenon Ogden's Utility & Energy practice group. He spent more than 26 years at the Kentucky Public Service 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.



2016 WATER LAW SERIES

October 25, 2016



2016 WATER LAW SERIES



Hot Legal Topics

October 25, 2016

Damon R. Talley, General Counsel
Kentucky Rural Water Association, Inc.
Stoll Keenon Ogden PLLC

damon.talley@skofirm.com

270-358-3187



DISCUSSION TOPICS

1. E-mail Address
2. Conflict of Interest Policy
3. Surplus Funds
4. ARF & the AG
5. Excessive Water Loss

Continued . . .

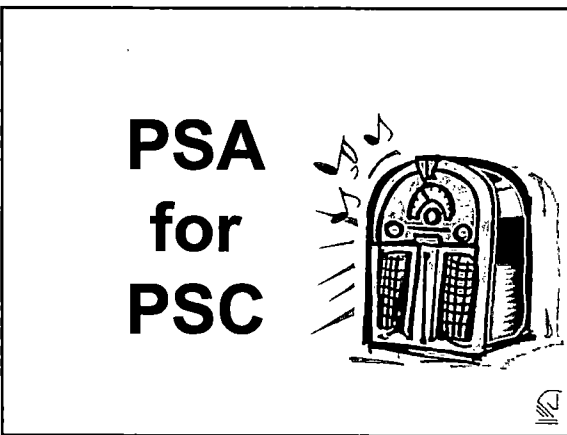


DISCUSSION TOPICS

- 6. Engineer's Recommendation of Award Letter
- 7. 911 Funding Update
- 8. GASB 68 & NPL PSC Rate Making









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

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

Talley's Tips



Default Regulatory E-mail Address

- Send E-mail to PSC
 - psc.reports@ky.gov
- Send Letter to PSC
 - Dr. Talina R. Mathews,
Executive Director



**PSA
for
PSC**



Reporting Requirements

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



Vacancy

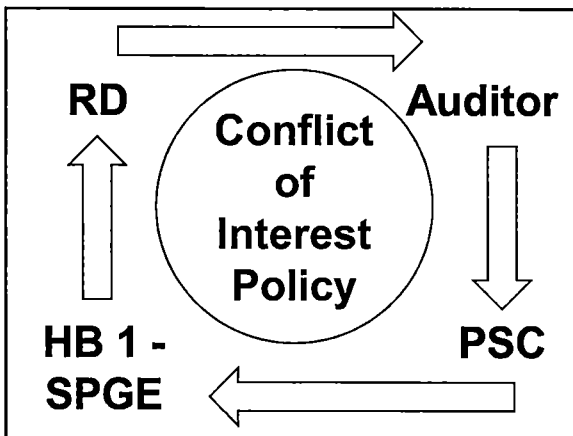
- Inform CJE 60 Days Before Term Ends (KRS 65.008)
- CJE / Fiscal Court – 90 Days
- Then, PSC Takes Over
 - CJE Loses Right To Appoint



Conflict of Interest Policy








PSC Disclosure Form

- Related Party Transaction
- Utility and . . .
 - Employees
 - Board Members
 - Family Members



**STATEMENT OF DISCLOSURE OF
RELATED PARTY TRANSACTIONS**

I swear or affirm to the best of my knowledge and belief the information set forth below represents all present transactions and those transactions occurring within the past twenty-four (24) months between _____ ("Utility") and related parties that exceed \$25.00 in value. For the purpose of this statement, "related party transactions" include, all transactions and payments in excess of \$25.00, except regular salary, wages and benefits, made directly to or on behalf of: 1) the Utility's current or former employees; 2) current or former members of the Utility's board of commissioners or board of directors; 3) persons who have a 10 percent or greater ownership interest in the Utility; 4) family members* of any current Utility employee, director, commissioner or person with a 10 percent or greater ownership interest in the Utility or 5) a business enterprise in which any current or former Utility employee, director, commissioner or person with a 10 percent or greater ownership interest in the Utility or a family member of such person has an ownership interest.





**RD
Conflict of
Interest Policy**



Who Is Covered?

- Water Associations
- Water Districts
- City Utilities
- All RD Borrowers



11. Conflict of Interest Policy

Prior to obligation of funds, you will certify in writing that your organization has in place an up-to-date written policy on conflict of interest. The policy will include, at a minimum: (1) a requirement for those with a conflict/potential conflict to disclose the conflict/potential conflict, (2) a prohibition of interested members of the applicant's governing body from voting on any matter in which there is a conflict, and (3) a description of the specific process by which the governing body will manage identified or potential conflicts.



You must also submit a disclosure of planned or potential transactions related to the use of Federal funds that may constitute or present the appearance of personal or organizational conflict of interest. Sample conflict of interest policies may be found at the National Council of Nonprofits website, <https://www.councilofnonprofits.org/tools-resources/conflict-of-interest>, or in Internal Revenue Service Form 1023, Appendix A, "Sample Conflict of Interest Policy," at <http://www.irs.gov/pub/irs-pdf/i1023.pdf>. Though these examples reference non-profit corporations, the requirement applies to all types of Agency borrowers.



RD Conflict of Interest Policy

1. Disclose Conflict
2. Don't Vote if Conflict
 - Abstain (More Later)
3. Process for Managing Conflict



Enforcement

- New RD Checklist
 - Certification
 - Not Yet – Working on It
- Letter of Conditions
 - Written Policy in Place



Talley's Take Aways



Need for Policy

- County Code of Ethics
Usually Not Broad Enough
- Water Assoc. Must Adopt
Its Own Policy
- City Utilities – Check with
City Attorney



Sample Policy

- Non-Profit Website
- Ask KRWA
 - Need to Develop One?



Abstaining From Voting



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



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

Cont.



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



Surplus Funds





Surplus Funds

- Old RD Policy
 - Flexible
 - Expand Project Scope
 - Buy Equipment, etc.
- Good Ole Days Are Over



Surplus Funds

- New RD Policy
 - Cannot Expand Project Scope After Bid Opening
 - Surplus Funds Forfeited
 - 10 % Contingency OK



Talley's Tips



Talley's Tips

- PER Is Key
 - Broad Project Scope
 - Include Wish List
- Use Deductive Alternates
- Use Additive Alternates



ARF & the AG

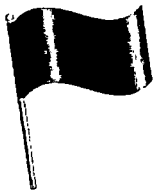


ARF & AG

- ARF – Historically
 - No Lawyers
 - No AG Intervention
- ARF – 2016
 - AG Looks at Every Case
 - Intervenes Often



Why Does AG Intervene?



Red Flags

- > 5 Years Since Last Rate Case
- > 10% Rate Increase
- Unequal Distribution of Increase
- Excessive Line Loss
- Wages & Benefits

Continued...



Red Flags

- High Interest Loans
- Size of Utility
- Utility – Past “Issues”
- Other Factors



AG Intervention

- Not Always Bad
- Mountain Water District
 - .023 Case (CPCN)
 - AG Intervened
 - AG Filed Data Request
 - Mountain Provided Info
 - AG Said: “Great Job!”
- PSC Order – Quoted AG



PSC Case No. 2016 – 266
Decided: 8-15-16
Utility: Mountain Water District
Type: CPCN - .023 Case
Holding: OK for AG to Intervene
CPCN Granted



Talley's Take Aways



Talley's Take Aways

- File Additional Docs with Application
 - Reason for Rate Increase
 - Rate Study
 - Need for Health Insurance Benefits
- Talk to AG in Advance
 - Explain "Situation"
 - Soften Opposition



Excessive Water Loss





PSC Case No. 2016 - 068
Decided: 8-17-16
Utility: Morgan County WD
Type: ARF
Issue: Excessive Line Loss



PSC Held:

- Water Loss 39%
 - 15% Maximum Allowed
 - Disallowed 24% Excess
- Disallowed \$135,000 Expenses Excess Water Loss (Cost to Purchase & Pump)



PSC Ordered:

"The Commission is concerned with **excessive water loss** and related costs and directs Morgan District to **develop and formally adopt a written plan to reduce excessive water loss**. The plan should identify all sources of water loss and each corrective action Morgan District will take to minimize water loss from each source."



Terms

- Unaccounted-for Water Loss
 - 15% Maximum
 - Allowance for Flushing, Etc.
- NRW – Non Revenue Water
 - No Allowance for Flushing
- Ray's Ratio



Ray's Ratio

Water Produced & Purchased
Water Sold

$$\frac{1,436,000}{1,306,673} = 1.099$$



Ray's Ratio

- Ray's Ratio: 1.099
- For Every 1,000 Gallons Sold
- Produce or Purchase:
1,099 Gallons
- Extraordinary !!!



Water Loss Comparison

	Utility	Unaccounted For Water	NRW	Ray's Ratio
1	Oldham Co.	7.4 %	9.0 %	1.099
2	North Nelson	9.5 %	12.2 %	1.139
3	Larue Co.	10.9 %	12.2 %	1.139
4	Warren Co.	12.4 %	13.0 %	1.149
5	Hardin #2 (Before)	11.6 %	14.4 %	1.169



Water Loss Comparison				
	Utility	Unaccounted For Water	NRW	Ray's Ratio
6	East Clark	14.4 %	15.7 %	1.187
7	KAWC	14.4 %	16.7 %	1.200
8	Webster	9.9 %	18.9 %	1.233
9	Carroll Co.	13.0 %	19.4 %	1.241
10	MWL - 1	12.1 %	25.3 %	1.340

Water Loss Comparison				
	Utility	Unaccounted For Water	NRW	Ray's Ratio
11	MWL - 2	14.4 %	28.3 %	1.395
12	EWL - 1	27.9 %	31.6 %	1.462
13	EWL - 2	21.5 %	32.2 %	1.476
14	EWL - 3	14.9 %	31.7 %	1.545
15	EWL - 4	37.1 %	51.4 %	2.058

**Talley's
Take
Aways**

Talley's Take Aways

- PSC & AG Are Serious About . . .
 - Excessive Water Loss
 - Higher Labor Costs
- You Need to be Serious . . .



Engineer's Recommendation of Award Letter



Engineer's Letter

"The bid order for this project was
_____ We have no reason
not to recommend that the project
award be project to _____"



Engineer's Letter

"Based on the results of the bid opening, it is **our recommendation** that the project be awarded to the low bidder, _____, contingent upon concurrence by K and upon PSC issuing a CPCN to the _____ Water District."



Need For Letter

- RD Checklist
- Not on PSC Checklist, but Expected
- Engineer's Job – Due Diligence
- Board Members Rely on Experts



911 Funding Update



Unresolved Legal Issues

- Does County Have Legal Authority to:
 - Impose 911 Fee on Water Service?
 - Compel City to Collect Fee?
 - Compel WD to Collect Fee?



Unresolved Legal Issues

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



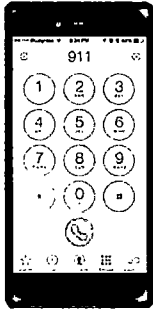
Unresolved Legal Issues

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



911 FEE

EMERGENCY
CALL 911

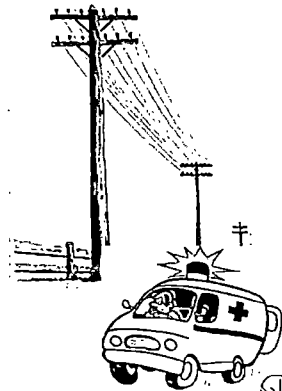


Funding 911 Call Center

- Historically . . . Telephone Land Line
 - Cell Phones - \$0.70
- New Funding Sources
 - Electric Utilities
 - Water Utilities
 - Parcel Fee



EMERGENCY
CALL 911



911 Meter Fee

- Garrard County Ordinance
 - Charge on Water Meters
 - Water Utilities Bill & Collect
 - Water Utilities Keep 2%



Garrard County Ordinance

- Water Meters
 - Active
 - Inactive
 - Storage
 - Distributor's Warehouse



911 Fee

- Litigation Update
- Nature of Fee
- Potential Problems for Utility
- Unresolved Legal Issues



Garrard County Case

City of Lancaster, et al

v.

Garrard County, Kentucky

Court of Appeals

Case No. 2013-CA-000716-MR

Opinion Rendered: 7-03-14

Opinion Vacated: 2-18-16



Campbell County Case

Greater Cincinnati / Northern Ky.
Apartment Assoc., Inc., et al

v.

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



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



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



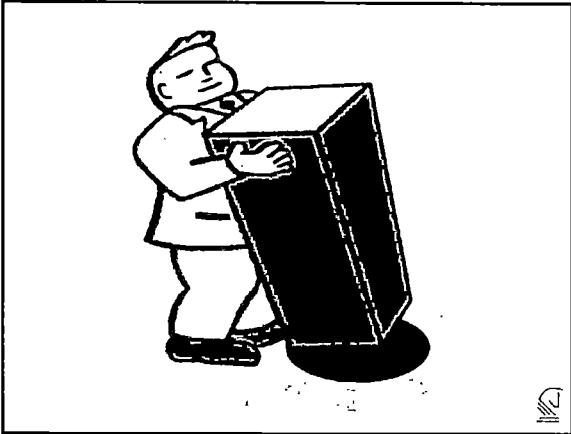
Parcel Fee Analysis

- Shocked Legal Scholars & Attorneys
- Some Reasonable Relationship:
 - No Direct Nexus Required
 - Actual 911 Usage Not Necessary
 - Occupied Properties OK



Dissenting Opinion





Dissenting Opinion

“Majority has opted, for better or worse, to chisel off the corners of the square peg so that what is in reality a flat-rate tax on real estate can be jammed into the round hole provided by statute for service fees.”

... Justice Venters

Current Status

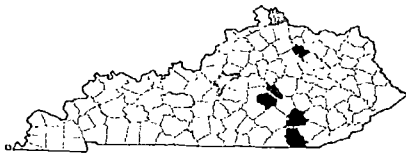
- Campbell County – Parcel Fee OK
- Garrard Co. – Water Meter Fee Invalid
 - 2-18-16 SC Vacated & Remanded
 - Reconsider in Light of Campbell Co. SC Case
 - Still Awaiting Ruling (10-25-16)

Statewide Impact





911 Alternate Funding



Red - Fee on Water
Green - Parcel Fee
Yellow - Under Consideration



Nature of Fee

- Fee on Customer or
- Fee on Utility
- Wording of Ordinance
- Role of Utility
 - Billing & Collection Agent
 - Tax Payer



Potential Problems for Utility

- PR Nightmare
- Add 911 Fee as Separate Line Item?
- Absorb Cost Until Next Rate Case?

...




Potential Problems for Utility

- Customers Don't Pay
- Termination of Water Service for Non-payment
- Possibility of Refund




PSC's Perspective

- Wait & See Approach
- No Case Pending
- 4 Staff Opinions
 - 2016-014
 - 2016-015
 - 2016-016
 - 2016-017




Your Role

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



**Talley's
Take
Aways**



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)





GASB 68 & NPL PSC Rate Making



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



Background GASB 68

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



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

Case Not Final



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



Staff Report

- Balance Sheet Treatment
 - Complicated
 - Creates Regulatory Asset
 - Prevents "Big Hit"
 - Avoids Wild Fluctuations
- Will PSC Approve?
- Stay Tuned . . .





damon.talley@skofirm.com

270-358-3187



BASICS OF KENTUCKY WATER SYSTEM FINANCINGS

Mark S. Franklin
Stoll Keenon Ogden PLLC
500 West Jefferson Street
Suite 2000
Louisville, Kentucky 40202
Phone: (502) 568-5460
Email: mark.franklin@skofirm.com

Sources Of Funds For Project Financings

Debt:

- Public Bond Markets
- United States Department of Agriculture, Rural Development ("USDA")
- Kentucky Infrastructure Authority ("KIA")
- Kentucky Rural Water Finance Corporation ("KRWFC")

Grants:

- Various federal and state sources

Lenders – Who Are They?

Public Bond Markets	Underwriters and institutional and retail investors
USDA, RD	Uncle Sam
KIA	State-wide agency established by the Kentucky Legislature
KRWFC	Kentucky nonprofit corporation established by the Kentucky Rural Water Association and its members

How Do They Work?

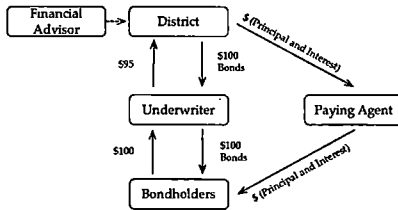
District Issues Bonds

- Public Bond Markets
- USDA, RD Financings

District Signs an Assistance Agreement

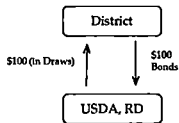
- KLA Financings
- KRWFC Financings

(Simplistic) Overview Of A Public Bond Markets Financing

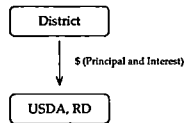


Overview Of A USDA, RD Financing

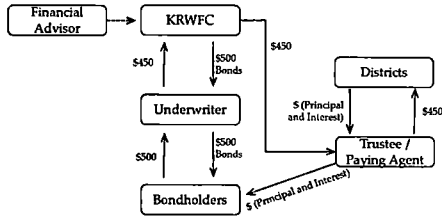
At "Closing"



During Administration



Overview Of A KRWFC Loan (Pool Financing)



Comparison Of The Four Options

	<u>Public Markets</u>	<u>USDA/RD</u>	<u>RTA</u>	<u>KRWFC</u>
Form	Multiple bonds (usually)	One bond	Assistance (loan) agreement	Assistance (loan) agreement
Permissible Use of Funds	New projects and refinancings	Only new projects benefiting rural areas	Only new projects	New projects and refinancings
Maximum Term	Up to 40 years, but 20 to 30 is more realistic	Up to 40 years	Up to 20 years, but up to 30 available	Up to 35 years
Variable Or Fixed Interest Rate?	Either	Fixed	Fixed	Fixed
How Many Interest Rates	Different rates for different annual maturities	One rate applies the entire life of the loan	One rate applies the entire life of the loan	Different rates for different annual maturities

Comparison Of The Four Options (Continued)

	<u>Public Markets</u>	<u>USDA/RD</u>	<u>RTA</u>	<u>KRWFC</u>
How Much Can You Borrow?	No legal limit; practical limit applies (credit worthiness, etc.)	Availability depends on amounts allocated to KY and project scoring	\$4 Million or \$5 Million, depending on the "funds" year loan originates from	No legal limit; practical limit applies (credit worthiness, etc.)
Credit Rating Required?	Yes	No	No	No
Reserve Funds Required?	Generally requires a debt service reserve fund and a repair and replacement fund	Generally uses existing replacement funds and will increase required deposits	Generally requires deposits to a replacement fund for the assets financed	No debt service reserve fund or replacement required for individual loans
Fees Charged?	Paying agent fee(s)	None	Fee = 0.20% or 0.25% of unpaid balance	\$250 or \$450 payable annually to trustee

Comparison Of The Four Options (Continued)

	WaterMark	USPA/RD	KIA	KBTC
Financial Reporting Requirements	Annual disclosure of operating and financial data to EMMA, a national web-based disclosure portal (SEC exposure)	Must provide USDA, RD audited financials within 180 days of 10 months of fiscal year end (dependent upon type of report provided)	Must provide KIA audited financial statements within 90 days of fiscal year end and other information upon request	Must provide KBTC audited financial statements within 180 days of fiscal year end and other information upon request
Closing Costs	High (underwriter, financial advisor, and rating fees)	Low	Low	Low

Operational Requirements Common To All Four Options:

Your financing documents require the District to:

- Maintain adequate insurance
- Charge adequate rates and fees to pay its operating expenses and debt payments
- Provide financial disclosure so your "lender" can monitor your financial performance
- Comply with requirements for the issuance of new debt

Requirements For The Issuance of New Debt

Requirements regarding the issuance of new debt:

- Bond resolutions and assistance agreements generally require water districts to demonstrate that the revenues of the water system will be sufficient to pay principal and interest on new and existing debts plus generate an additional "cushion" before new debt can be incurred
- Someone (a district official, CPA, or engineer) must certify that the "cushion" or coverage test is met
- Typical "cushion" is net revenues (revenues after payment of all expenses except principal and interest) for a given period must be at least 120% or 130% of principal and interest payments for the same period

Relative Rights Of Bondholders And Lenders

- Debts can exist on a "parity" basis or may be superior or subordinated to other debts
- Your lenders' respective rights depend on the requirements of existing bond and loan documents each time a new debt is incurred
- Public bond markets usually demand "first place" status, whether by themselves or on a parity with other debt
- This must be managed and examined each time you borrow money to avoid breaking existing covenants and planning for future needs

Why Tax-Exempt Debt?

Tax-exempt interest rates are lower than taxable interest rates because bondholders and lenders do not have to pay tax on the interest they receive, thus they can offer lower interest rates and still receive the same rate of return.

Comparison Of Three Types of Interest Rates

	Taxable	Tax-Exempt	Tax-Exempt (Tax-Adjusted)
Interest Rate Needed To Generate Desired Return	5.00%	4.13%	3.43%
Interest Income	\$100.00	\$82.50	\$68.50
Associated Expenses	\$50.00	\$50.00	\$50.00
Net Income Before Taxes	\$50.00	\$32.50	\$18.50
Applicable Tax Rate	35.00%	35.00%	35.00%
Tax Liability	\$17.50	\$0.00	(\$14.00)
Net Income After Taxes	\$32.50	\$32.50	\$32.50

Our Friends At The IRS

- The issuance of any tax-exempt debt has to be reported to the IRS using IRS Form 8038G (Bond Counsel function)
- The IRS can audit any tax-exempt debt for compliance with federal tax law during the life of the loan and up to three years afterwards (keep good records!)
- If the IRS determines the debt was ineligible for tax-exemption, you will owe a settlement payment to the IRS equal to the difference between the interest generated by tax-exempt and taxable rates (monitoring compliance is important!)

What To Look For

- Tax-exempt loan proceeds sitting in a bank account earning interest for long periods of time (e.g., debt service reserve funds, replacement funds, and construction funds)
- Change in use or sale of a financed project (begin leasing a facility to a non-governmental utility)
- Arrangements where a non-governmental entity is using financed facilities to make money (management contracts, etc.)

2016 Water Law Series

October 25, 2016
Bowling Green, KY

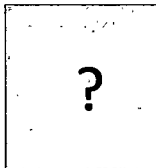
**What is WOTUS?
And Why Should I Care?**

By:
Lajuana S. Wilcher, English, Lucas, Priest & Owsley, LLP
Bowling Green, KY

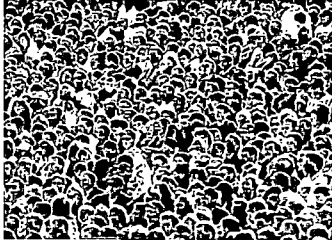


Which of these
is not like the others?

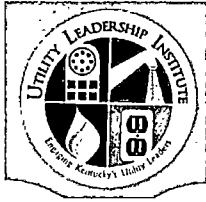
- A. POTUS B. FLOTUS
- C. SCOTUS D. WOTUS



Who Should Care?



Utility Managers and Staff



- Construction of Buildings
- Installation of Tanks
- Development of Water Sources
- Installation of Utility Lines
- Build a Road (even temporary)
- Stream Crossing?

1 of 5



ASSOCIATION OF
METROPOLITAN
WATER AGENCIES



Association of
California Water Agencies
3901 F Street, N.W.
Washington, D.C. 20007



American Water Works
Association



National Association
of Water Companies

November 14, 2014

Water Docket, EPA Docket Center
EPA West, Room 3334
1301 Constitution Avenue NW,
Washington, DC

RE: Proposed Rule - Definition of "Waters of the United States" Under the Clean
Water Act (Docket ID No. EPA-HQ-OIV-2011-0350)

The undersigned organizations represent the full spectrum of drinking water and
wastewater service providers from both public and private sectors. Our organizations'
members include both publicly owned and investor-owned utilities serving communities
throughout the United States. We appreciate the opportunity to comment on the bill.

• CWA Section 404 provides that a person may not discharge “dredged or fill material” into “navigable waters of the United States” without a permit issued by the [U.S. Army Corps of Engineers].

• CWA Section 502 (7) *The term “navigable waters” means the waters of the United States*, including the territorial seas.

Joint Administration of Section 404



What “Waters” Are Covered by the CWA?



What "Waters" Are Covered by the CWA?

What Waters are WOTUS Subject to the CWA?

Concrete lined conveyances? Intermittent? Ephemeral?

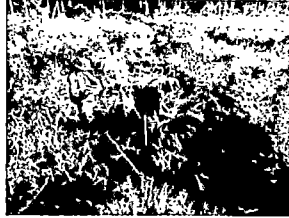
What "Waters" Are Covered by the CWA?

Natural Resources Defense Council, Inc. v. Callaway, (D.C.) 1975

By defining the term 'navigable waters' to mean 'the waters of the United States, including the territorial seas,' Congress "asserted federal jurisdiction over the nation's waters to the maximum extent permissible under the Commerce Clause of the Constitution."

What is a wetland?

"... those areas that are inundated or saturated by surface or groundwater at a frequency and duration sufficient to support, and that under normal circumstances do support, a prevalence of vegetation typically adapted for life in saturated soil conditions. Wetlands generally include swamps, marshes, bogs and similar areas."



1977 CWA Amendments

Added Section 404 (g) (1) The Governor of any State desiring to administer its own individual and general permit program for the discharge of dredged or fill material into the navigable waters (other than those waters . . . which [are] or are susceptible to use . . . as a means to transport interstate or foreign commerce . . . **including wetlands adjacent thereto**), within its jurisdiction may submit to the Administrator a full and complete description of the program it proposes to establish and administer under State law

What "Waters" Are Covered by the CWA?



U.S. v. Riverside Bayview Homes, Inc., (1985) The Corps' interpretation of "the waters of the United States" includes wetlands that "actually abut" on "traditional navigable waters."

What "Waters" Were Covered by the CWA?

- Defined by regulation
 - Waters used in interstate or foreign commerce
 - Interstate waters including interstate wetlands
 - "Other waters" which could affect interstate or foreign commerce, including those which are or would be used as habitat by... migratory birds that cross state lines
 - Impoundments of waters that would otherwise be within definition of waters of the United States
 - Tributaries of the above-listed waters
 - Territorial seas
 - Wetlands adjacent to waters



SWANCC v. Army Corps of Engineers
531 U.S. 159 (2001)

Corps exceeded its authority by asserting CWA jurisdiction over isolated, inland, non-navigable waters



EPA/Corps Guidance 2003

In the wake of SWANCC, EPA and the Corps issued guidance.

Abandoned 'Migratory Bird Rule' but jurisdictional reach remained broad.



Rapanos v. U. S., 547 U.S. 715 (2006)
No majority opinion (4-4-1)

- Scalia plurality . . . the term “waters of the United States” includes “only those relatively permanent, standing or continuously flowing bodies of water ‘forming geographic features’ that are described in ordinary parlance as ‘streams, oceans, rivers and lakes’”
- Kennedy concurrence...waters with a “significant nexus to waters that are navigable in fact or that could reasonably be so made.”

Chief Justice Comments

"In response to the *SWANCC* decision, the Corps and the Environmental Protection Agency (EPA) initiated a rulemaking..."

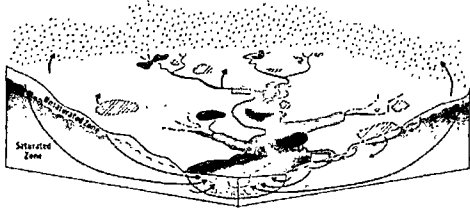


The proposed rulemaking went nowhere. Rather than refining its view of its authority... the Corps chose to adhere to its essentially boundless view of the scope of its power. The upshot today is another defeat for the agency."

Guidance and More Guidance

- June 2007 Memorandum of Agreement
- June 2007 Legal Memorandum
 - Public comments on Rapanos Guidance
 - Guidance revised
- December 2, 2008 Memorandum on Clean Water Act Jurisdiction Following Rapanos
- 2011 Draft Guidance
 - Extended comment period
 - Withdrawn

From EPA's Report on "Connectivity"



Perennial stream	Wetland with surface outlet	Geographically isolated wetland	Evapotranspiration
Intermittent stream	Floodplain	Overland flow (HS and SPD)	Surface flows
Ephemeral stream	Riparian floodplain wetland	Hyporheic zone	



The Clean Water Rule (WOTUS)



In 2015, EPA and the Corps published the newly named "Clean Water Rule: Definitions of 'Waters of the United States,'" after publishing a proposed rule and receiving 698,836 comments. 80 FED. REG. 37,054 (June 29, 2015).

FACTSHEET
CLEAN WATER RULE

- Defines tributary for the first time as water features with bed, banks, an ordinary high water mark, and downstream flow, additional case by case evaluations for adjacency.
- Includes waters adjacent to jurisdictional waters within a minimum of 100 feet and within the 100-year floodplain to a maximum of 1,500 feet of the ordinary high water mark.

FACTSHEET
CLEAN WATER RULE

- Includes specific waters that are similarly situated: Prairie potholes, Carolina & Delmarva bays, pocosins, western vernal pools in California, & Texas coastal prairie wetlands when they have a significant nexus.
- Includes waters with a significant nexus within the 100-year floodplain of a traditional navigable water, interstate water, or the territorial seas, as well as waters with a significant nexus within 4,000 feet of jurisdictional waters.

American Farm Bureau Federation



6th Circuit Court of Appeals

October 9, 2015: Rule stayed

"... we conclude that petitioners have demonstrated a substantial possibility of success on the merits of their claims."

February 22, 2016: 6th Circuit has jurisdiction over the petition for review the Clean Water Rule.

Briefing Schedule:

Petitioners due September 30th.
Agencies' consolidated response due November 30.
Intervenor's briefs due December 14.
Petitioners' consolidated reply due January 20.
Joint appendix due February 3rd.



So How Do You Get a Permit?



- Individual Permit?
- General Permit?
- Letter of Permission?
- 401 Certification?
- NEPA?
- ESA?
- NHPA
- 1987 Delineation Manual
- Regional Delineation Manuals



FEDERAL REGISTER

Vol 77 Tuesday,
No 34 February 21, 2012

Part III

Department of Defense
Department of the Army, Corps of Engineers
Bureau of Land Management, Public

Nationwide Permit 12 Utility Line Activities

CWA

What is a WOTUS? It depends on the day (or at least the month or the year or the Administration).

What is or is not regulated has changed over time . . . Even though the statute has not!

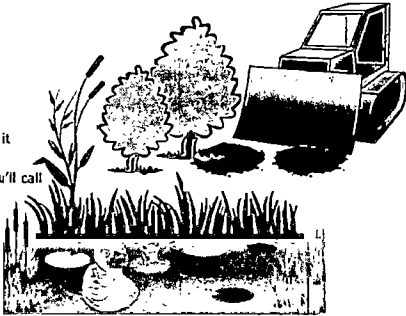


Conclusion

Moving dirt? Be alert
For fish and frogs and muck.
For if its wet, you'll regret
Not caring for a duck.

If soil is hydric, please don't try it
Unless you are permitted.
Don't break the law or soon you'll call
For help or be committed.

Don't be scared, just be aware
Of rules and regulations.
Do not cry. Just comply.
End of indoctrination.



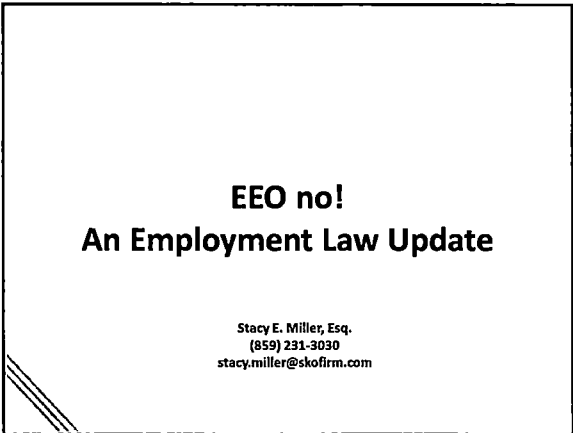
Questions?

Contact
LaJuana S. Wilcher, English,
Lucas, Priest & Owsley, LLP
1101 College Street
Bowling Green, KY
lwilcher@elpolaw.com
860-227-3524



**At the speaker's
request, copies of this
presentation were not
included in the
handouts.**









Pop Quiz

- ✦ True or False? All salaried employees are exempt from overtime.



FLSA Exemptions

- ✦ Executive employees
- ✦ Administrative employees
- ✦ Professional employees
- ✦ Outside sales employees
- ✦ Computer systems analysts, computer programmers and other similarly skilled computer employees
- ✦ Employees working in specified industries (e.g., transportation, bulk oil distribution, hospitals, seasonal businesses, communications, agriculture)
- ✦ Employees performing certain types of work (e.g., commissioned retail salespersons, fishers, taxicab drivers, newspaper delivery persons)
- ✦ Casual babysitters and companions for the disabled or elderly
- ✦ Employees working under special certificates
- ✦ Highly compensated employees



FLSA EAP Exemptions

Three Requirements for Exempt Status:

- ✦ **Duties:** Performs work activities that primarily involve prescribed duties
- ✦ **Salary Basis:** Regularly paid a predetermined amount
- ✦ **Salary Threshold:** Earns at least a designated, minimum weekly salary



Executive Employee Duties

- ✦ The employee's **primary duty is management** of the enterprise, or a department or subdivision
- ✦ The employee customarily and regularly **directs** the work of two or more other full-time employees; and
- ✦ The employee has the **authority to hire or fire** other employees, or the employee's suggestions and recommendations as to the hiring, firing, or other change of status are given particular weight



Administrative Employee Duties

- ✦ The employee's **primary duty** is the performance of office or non-manual work **directly related to the management or general business operations** of the employer or the employer's customers; and
- ✦ The employee's primary duty includes the exercise of **discretion and independent judgment** with respect to **matters of significance**.



Learned Professional Duties

- ✦ The employee must perform work requiring **advanced knowledge**;
- ✦ The advanced knowledge must be in a **"field of science or learning,"** and
- ✦ The advanced knowledge must be customarily acquired by a prolonged course of **specialized intellectual instruction**.



Computer Employee Duties

- ❖ The **application of systems analysis** techniques and procedures, including consulting with users, to determine hardware, software or system functional specifications;
- ❖ The design, development, documentation, analysis, creation, testing or modification of **computer systems** or programs, including prototypes, based on and related to user or system design specifications;
- ❖ The design, documentation, testing, creation or modification **computer programs** related to machine operating systems; **OR**
- ❖ A **combination** of the aforementioned duties, the performance of which requires the same level of skills



Computer Employee Duties

- ❖ **Examples:**
 - Computer systems analysts,
 - Computer programmers,
 - Software engineers or
 - Other similarly skilled workers in the computer field
- ❖ **Job titles NOT determinative**
- ❖ **Does NOT include manufacture or repair**



Highly Compensated Employees

- ❖ The employee's "**total annual compensation**" meets a minimum annual salary threshold which includes the minimum weekly threshold amount paid on a salary basis; and
- ❖ The employee customarily and regularly performs **any one or more of the exempt duties** of white collar employees.



Salary Tests

- ✦ **Salary Basis:** Regularly paid a predetermined amount
 - Paid on a salary basis (not hourly)
 - Some exceptions (e.g., computer employees)
 - Strict rules regarding deductions
- ✦ **Salary Threshold:** Earns at least a designated, minimum weekly salary
 - Currently \$455/week or \$23,660/year (\$100,000/year for Highly Compensated Employees)



Salary Tests – Revised Regulations

- ✦ Revised regulations released May 18, 2016
- ✦ Intended to “modernize and simplify”
- ✦ Minimum Salary Threshold raised from \$455 per week (\$23,660 per year) to **\$913 per week (\$47,476 per year)**
- ✦ Highly Compensated Employee exemption: total annual compensation amount increased from \$100,000 to **\$134,004 (min. \$913/week)**



Salary Tests – Revised Regulations

- ✦ Automatic adjustment every 3 years, starting in 2020
- ✦ Nondiscretionary bonuses or commissions can satisfy up to 10% of salary - but only if paid quarterly or more frequently
 - Not available for the HCE exemption (must receive at least \$913/week)
- ✦ Effective date: December 1, 2016



Challenges

- ◊ Opposition from business groups during comment period
- ◊ Congressional action
 - Congressional Review Act
 - Protecting Workplace Advancement and Opportunity Act
 - Regulatory Relief for Small Businesses and Nonprofits Act
 - Overtime Reform and Enhancement Act
- ◊ Litigation challenging agency's rulemaking procedures
- ◊ *Regardless, employers should take steps to comply ahead of December 1*



Pop Quiz

- ◊ True or False? Pregnant employees' work restrictions must be accommodated (e.g., lifting, standing, or bending restrictions).



U.S. Supreme Court

- ◊ **Young v. UPS** – Pregnancy discrimination
 - Prima facie case of pregnancy discrimination:
 - Protected class
 - Sought accommodation
 - Employer did not accommodate her
 - Employer accommodated others "similar in their ability or inability to work"
- ◊ Employer must have "sufficiently strong" nondiscriminatory reason for facially neutral policies that impose "significant burden" on pregnant employees



Pop Quiz

An employer thinks (**but does not know for certain**) that a job applicant may be an orthodox Jew who will observe the Sabbath and thus unable to work on Saturdays. The employer routinely operates on Saturdays. May the employer refuse to hire the applicant because of its belief that the applicant cannot work on Saturdays?



U.S. Supreme Court

EEOC v. Abercrombie & Fitch – Religious Accommodation

- Job applicant can establish religious discrimination without proof employer had “actual knowledge” of need for an accommodation
- Need for accommodation need only be a “motivating factor” in employer’s decision
- Employers must actively make exceptions to neutral employment policies to accommodate religious practices



Federal Appellate Court

Ruffin v. Motor City Casino (6th Circuit) – Employee meal breaks

- Holding: time spent monitoring work radios during meal times is generally not compensable under the FLSA
- Consider:
 - Whether employee performed substantial duties
 - Whether employer business regularly interrupts the meal period
 - Employee’s ability to leave the premises



Federal Appellate Court

- ◆ **EEOC v. Ford Motor Company (6th Circuit) – Disability Accommodation**
 - Plaintiff, a steel resale buyer, suffered from IBS and claimed need to work from home, Ford refused claiming attendance was essential function of her job
 - Holding: regular and predictable on-site attendance was an essential function of her job
 - With regard to jobs involving teamwork and high level of interaction, employers can require regular attendance



EEOC Retaliation Guidance

- ◆ **Protected activity**
 - Includes internal proceedings
 - Recognizes “implicit” opposition
- ◆ **Adverse action**
 - Need not have tangible effect on person’s employment
- ◆ **Causal connection**
 - Could include: suspicious timing, verbal or written statements, comparative evidence, or any other circumstantial evidence



Pop Quiz

- ◆ True or False? Title VII protects employees from discrimination based on race, color, religion, national origin and sexual orientation.



Sexual Orientation Discrimination – Federal Agency Decisions

- **Baldwin v. Foxx** (EEOC July 2015) – Sexual Orientation Protected by Title VII
 - EEOC ruling goes against decades of precedent
 - “Discrimination on the basis of sexual orientation is premised on sex-based preferences, assumptions, expectations, stereotypes, or norms. ‘Sexual Orientation’ as a concept cannot be defined or understood without reference to sex.”



Sexual Orientation Discrimination – Federal Appellate Court Decisions

- **Hively v. Ivy Tech Community College, South Bend** (7th Circuit 2016)
 - Title VII prohibits discrimination on the basis of sex (gender, pregnancy) but not on the basis of sexual orientation
 - Other circuits have affirmed that Title VII does not prohibit discrimination on the basis of sexual orientation despite EEOC’s contrary position on the matter





Kentucky Cases

Barber v. United Postal Service, Inc. (Fayette 2016)

- Racial harassment claim
- Effigy of black driver hung by time clock
- \$5.3 million verdict
- Motion to overturn verdict denied
 - "The evidence was [the managers] didn't do anything."
 - Judge Scorsone
- Currently on appeal



Kentucky Minimum Wage

Kentucky Restaurant Association, Kentucky Retail Federation v. Louisville/Jefferson County Metro Government (Ky. S. Ct. Oct. 20, 2016)

- Louisville Metro passed an ordinance to increase minimum wage from \$7.25/hr to \$7.75 in 2015, \$8.25 in 2016 and \$9.00 in 2017
- Kentucky minimum wage is \$7.25/hr
- Held: the ordinance unlawfully prohibits what state law allows (i.e., paying employees \$7.25/hr)



Accounting and Auditing Issues for Water Utilities

Brian S. Woosley, CPA
Stiles, Carter & Associates, PSC
270-769-6371
brian@scacpa.com

Audit Basics

Hiring An Auditor

Elements To Consider (Requests For Proposal)

- Quality And Qualifications Of Audit Firm
 - Peer Review
 - Governmental Experience
 - Industry Experience
- Audit Price
 - Evaluate After Selecting Qualified Firms
- Term Of Contract
 - Longer Contracts Can Lead To Better Efficiency

Audit Basics

Conducting The Audit Work Schedule

- Audit Fieldwork
- Audit Exit Conference
- Report Delivery
- Audit Findings
 - Corrective Action Plan
 - Addresses Audit Findings
 - Illustrates Solutions

Audit Basics

Financial Statement Audit – What’s Included

- Financial Statements
 - Statement Of Net Position
 - Statement Of Revenues, Expenses and Changes in Fund Net Position
 - Statement of Cash Flows .
- Notes To The Financial Statements
- Required Supplementary Information
 - Management’s Discussion And Analysis
 - Pension Schedules

Audit Basics

- Suitable Skill, Knowledge or Experience (SKE)
 - Management Must Possess
 - Must Understand Non-Audit Service Provided
 - Drafting of Financial Statements
 - Drafting of Schedule of Expenditures of Federal Awards
 - Not Required to Possess the Expertise to Perform or Re-Perform Services
 - Auditor Required to Document SKE

Uniform Guidance

- Found in 2 CFR 200
- Title – Uniform Administrative Requirements, Cost Principles and Audit Requirements for Federal Awards
- Combined All Related OMB Guidance into one Location
- Effective Date 12/26/2014
- Review at <https://cfo.gov/cofar>

Uniform Guidance

- Required to Document in Writing Procedures Over
 - Payments Received
 - Procurement (including conflict of interest)
 - Allowability of Costs
 - Compensation
 - Travel Costs

Uniform Guidance

Audit Requirements

- Covers All Federal Funds Expended; Threshold \$750,000
- Major Programs Audited
- Must Audit 40% Of Federal Dollars Expended As Major Programs Unless Utility Qualifies As A Low-Risk Auditee, Then Only 20% Must Be Audited
- Low-Risk Auditee (Must Have The Following In Both The Past Two Fiscal Years)
 - Single Audits Performed
 - Audit Opinions On The Financial Statements And The Schedule Of Expenditures Of Federal Awards Were Unqualified
 - The Yellow Book Report On Internal Control Did Not Identify Material Weaknesses
 - Auditor Did Not Report a Substantial Doubt About Going Concern
 - No Type A Programs Had Findings
 - Data Collection Form Must Be Filed Timely

Those Charged With Governance

- Persons Responsible for Overseeing the Strategic Direction of the Entity
- Independent from Management
- Oversight
 - Process for Reviewing Effectiveness of Internal Controls
 - Reviewing Financial Information
 - Budgets
 - Financial Statements
 - Disbursements

Those Charged With Governance

- Form an Audit Committee
- Have Code of Ethics
- Establish an Independent Process to Examine Concerns Related to the Organization – Whether Internal or External
- Establish Personnel Compensation and Benefits Policy and Employee Evaluation System

Those Charged With Governance

- Auditor Should Communicate With Those Charged With Governance During Planning and Final Stages Of Audit
- Auditor Should At A Minimum Interview Board Chair
- Board Members Should Have Open Line Of Communication With Auditor

Internal Controls

- SAS 115
 - Terminology
 - Control Deficiency – A Control Does Not Allow Management or Employees In The Normal Course of Performing Their Assigned Functions To Prevent Or Detect and Correct Misstatements On A Timely Basis
 - Significant Deficiency – Deficiency, or a Combination of Deficiencies, in Internal Control that is Less Severe than a Material Weakness, Yet Important Enough to Merit Attention by those Charged with Governance

Internal Controls

- Material Weakness – A Deficiency or Combination of Deficiencies In Internal Control Such That There is a Reasonable Possibility That A Material Misstatement of the Entity's Financial Statements Will Not Be Prevented, Or Detected and Corrected on a Timely Basis
- Examples of Significant Deficiencies
 - Lack Of Expertise in Applying Generally Accepted Accounting Principles
 - Inadequate Design of Controls
 - Failure of Controls to Safeguard Assets

Internal Controls

- Examples of Material Weaknesses
 - Lack Of Oversight By Those Charged With Governance
 - Material Restatement Of Previously Issued Financial Statements
 - Identification By The Auditor of a Material Misstatement that Would Not Have Been Detected by the Entity's Internal Control
 - Fraud Of Any Amount By Senior Management
 - Inability To Prepare Financial Statements
- Written Communication Required

Internal Controls

Segregation Of Duties

- Used To Ensure That Misstatements Are Prevented Or Detected On A Timely Basis By Employees In The Normal Course Of Business
- Two Benefits
 - A Deliberate Fraud Is More Difficult Because It Requires Collusion Of Two Or More Persons
 - It Is Much More Likely That Innocent Errors Will Be Found
- No Single Individual Should Have Control Over Two Or More Phases Of A Transaction Or Operation

Internal Controls

Segregation Of Duties

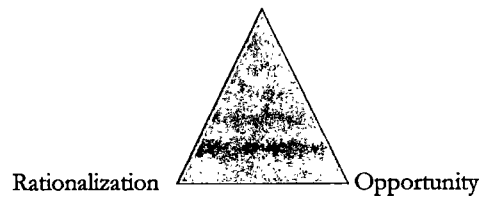
- Incompatible Duties
 - Authorizing A Transaction And Receiving And Maintaining Custody Of The Asset That Resulted From The Transaction
 - Depositing Cash And Reconciling Bank Statements
 - Approving Time Cards And Having Custody Of Paychecks
 - Having Unlimited Access To Assets, Accounting Records And Computer Programs. For Instance Having Access And Using Checks As The Source Documents To Post To Accounting Records Rather Than Using A Check Log Or Receipts

Fraud

- Fraud Is Very Difficult To Detect
- Management Is Responsible For Establishing And Maintaining Controls To Prevent And Detect Fraud
- Fraud Is Easier To Prevent Than Detect
- Strong Internal Control Is The Best Way To Protect Against Fraud

Fraud

Fraud Triangle Motivation



Fraud

The 10-80-10 Rule

- 10% Of People Would Never Do Anything Dishonest Under Any Circumstances
- 10% Are Always Looking
- 80% Might Commit Fraud Given The Right Motivation, Opportunity and Rationalization

Fraud

Fraudster Profile

- Someone Like You And Me
 - Who Is Faced With Unbearable Financial Pressure
- AND
- Perceives An Opportunity To Deal With The Pressure Without Getting Caught

Fraud

Motivation

- Greed
- Unbearable Financial Pressure – Different For Different People
 - I Need A New Car
 - Medical Bills
 - Looming Bankruptcy
 - Gambling Addiction

Fraud

Rationalization

- Some Fraudsters Are Shameless And Remorseless
- Most Fraudsters Don't Think They Are Evil
- Therefore, Fraudsters Can Rationalize Theft

Common Rationalizations

- Everybody Does It
- They Don't Pay Me Enough
- I'm Just Borrowing/I'll Pay It Back
- Management Deserves It

Fraud

Opportunity

- Every Internal Control Weakness Is An Opportunity
- Lack Of Segregation Of Duties
- Collusion Can Happen

Fraud

What To Look For

- Employees
 - Lifestyle Changes
 - Significant Personal Debt/Credit Issues
 - Behavioral Changes
 - Drug Or Alcohol Issues
 - Gambling
 - Fear Of Losing Job
 - Refusal To Take Vacations
 - Lack Of Segregation Of Duties

Fraud

What To Look For (Continued)

- Management
 - Excessive Number Of Checking Accounts
 - Frequent Bank Changes
 - Frequent Change in External Auditors
 - Reluctance To Provide Information To Auditors
 - Financial Pressures To Meet Requirements
 - Large Number Of Related Party Transactions

Fraud

Indicators Of Fraud

- Cash
 - Large Number Of Voids
 - Unauthorized Bank Accounts In District Name
 - Discrepancies Between Bank Deposits And General Ledger Posting
 - Bank Accounts Not Timely Reconciled
- Payroll
 - Employees With Duplicate Social Security Numbers, Names Or Addresses
 - Employees With Few Or No Payroll Deductions

Fraud

Fraud Prevention Techniques

- Control The Mail
 - Have The Mail Picked Up By An Employee Who Has No Responsibilities Related To The Handling Or Recording Of Deposits, Accounts Receivable Records Or Revenues
- Control Accounts Payable
 - Establish And Monitor Approved Vendor Lists
 - Review Vendor Lists For
 - Unknown Vendors
 - Vendors With Names Similar To Other Known Vendors
 - Vendors With No Physical Address Or Telephone Number
 - Vendors Whose Addresses Match Employee Addresses

Fraud

Fraud Prevention Techniques (Continued)

- **Control The Bank Statements**
 - Have Bank Statements Picked Up By Someone In Upper Management With No Responsibilities Related To Recording Of Deposits, Accounts Receivable Records, Revenues Or Cash Disbursements
 - This Person Should Review The Bank Statements And Be Alert For
 - Missing Checks
 - Checks Issued Out Of Sequence
 - Unknown Payees
 - Checks That Appear To Have Been Altered
 - Checks Not Signed By Authorized Signatories
 - Large Number Of Transfers In Or Out
 - Other Unusual Items

Fraud

Fraud Prevention Techniques (Continued)

- **Account For Sequences**
 - Whether It Is Checks, Invoices, Credit Memoranda, Receiving Reports, Shipping Documents, Or Other Prenumbered Items, All Sequences Should Be Accounted For. Voided Documents Should Be Defaced To Prevent Unauthorized Use And Retained To Complete Sequences.
- **Control General Journal Entries**
 - Finance Officer Should Either Make Or Personally Review And Approve All General Journal Entries. Supporting Documentation Should Be Reviewed Before Approving General Journal Entries
 - In Particular, The Following Items Should Be Investigated
 - Entries Made To Unrelated Accounts
 - Entries Made To Receivables Or Revenues At Or Near The Close Of A Period
 - Entries Made By Persons Whose Responsibilities Are Not Consistent With The Accounts Being Adjusted

Fraud

Fraud Prevention Techniques (Continued)

- **Perform Thorough Background Checks On All New Employees**
 - Call Former Employers And Educational Institutions For Verification Of Previous Employment And Education. Beware Of "Gaps" In Employment Or Educational History. Consider Obtaining A Credit Report (If Authorized By The Candidate) Before Employment.
- **Provide Employees An Opportunity To Report The Occurrence Of Fraud Or Other Abuse Anonymously**
 - In A Recent Survey, One In Five Employees Said They Were Personally Aware Of The Occurrence Of Fraud In The Workplace. Eighty Percent Said They Would Be Willing To Report Fraud If They Did Not Have To Identify Themselves. Management Can Establish Hotlines, "Suggestion Boxes" Or Other Means To Enable Employees To Bring The Occurrence Of Fraud To Its Attention Without Requiring Employees To Give Their Names.

Fraud

Fraud Prevention Techniques (Continued)

- Clearly Communicate To Employees The Behavior That Is Expected Of Them
 - Believe It Or Not, Ignorance Has Been Cited As A Common Cause Of Fraud. Some Employees Have Been Trained To Commit Fraudulent Acts Without Knowing What They Were Doing, Just Assuming That "That's The Way It's Done".
- Take Strong Action Against Employees Who Commit Fraud
 - Call The Police Or Other Law Enforcement Agency And Press Charges. Failing To Do So Sends A Message To Other Employees That Management Doesn't Take Fraud Seriously.

Fraud

Fraud Prevention Techniques (Continued)

- Obtain Reasonable Fidelity Bond Coverage
 - If The Unthinkable Occurs, Insurance Coverage Is The Most Likely Means Of Recovery Of Amounts Misappropriated. The Amount Of Coverage Should Be Reviewed Periodically For Adequacy.
- Provide Employees With Proper Training
- Establish An Audit Committee

Fraud

- Auditor's Role
 - Auditor Must Ask About Fraud
 - Be Candid In Your Answers
 - This May Be The Only Opportunity The Auditor Has To Discuss Fraud
 - Auditor Is Only Responsible For Detecting Fraud That Could Have A Direct And Material Effect On The Financial Statements

GASB

- GASB – Governmental Accounting Standards Board
- Responsible for Setting Accounting Standards for U.S. State and Local Governments
- Currently 82 GASB Pronouncements

GASB 68

- Standard was required to be adopted for fiscal years beginning after June 15, 2014 (12/31/15)
- Allowed to use data no older than 18 months
- Requires employers to record proportionate share of pension liabilities for plans where employer has legal responsibility to contribute

GASB 68

- Foundation of the standard is to bring more awareness to unfunded pension liabilities
- Standard provides comparability between reporting entities and the business community
- Accounting and funding are not linked
- In addition to adjustments in the financial statements, more RSI and notes

GASB 68

- CERS – Members will report in their financial statements net pension liability, deferred outflows and inflows of resources and pension expense
- Total pension liability – the portion of the actuarial present value of projected benefit payments attributed to past periods or member service

GASB 68

- GASB 62 in Paragraphs 476-500 Covering Regulated Operations, Allows for the Effects of the Rate-Making Process to be Recorded in the Financial Statements
- Board Can Elect to Apply to GASB 68
- Result Would Record a Regulatory Asset for the Net of the Net Pension Liability, Deferred Outflows of Resources and Deferred Inflows of Resources
- Actuarially Determined Contributions=Pension Expense

GASB 68

- Required Supplementary Information
 - 10 year schedule of changes in employer's proportion of the collective NPL and related key ratios
 - 10 year schedule of actuarially determined employer contributions and actual amounts contributed
 - Notes to the RSI

■ *GASB 75, Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*

- *Generally, mirrors the requirements of GASB 68 for employer reporting of pensions*
- *Effective for December 31, 2018 year*

Brian S. Woosley, CPA
Stiles, Carter & Associates, PSC
270-769-6371
brian@stiles-cartercpas.com

Appendix to Accounting Issues

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



GASB 68 & NPL PSC Rate Making



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



Background GASB 68

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



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

Case Not Final



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



Staff Report

- Balance Sheet Treatment
 - Complicated
 - Creates Regulatory Asset
 - Prevents "Big Hit"
 - Avoids Wild Fluctuations
- Will PSC Approve?
- Stay Tuned . . .






damon.talley@skofirm.com

270-358-3187





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**RECENT DEVELOPMENTS IN
 UTILITY LAW**

**2016 Utility Leadership Institute Water Law Series
 October 25, 2016**

<p>Damon Talley Stoll Keenon Ogden PLLC damon.talley@skofirm.com Hodgenville, Kentucky (270) 358-3187</p>	<p>Gerald Wuetcher Stoll Keenon Ogden PLLC gerald.wuetcher@skofirm.com https://twitter.com/gwuetcher (859) 231-3017</p>
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ORDER OF PRESENTATION

- Recent Legislation
- Personnel Changes at PSC
- PSC Funding & Organization
- Significant Rate Issues
- Water District Commissioners
- Use of Attorneys In Regulatory Proceedings

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RECENT LEGISLATION

HOUSE BILL 303

- Bright-Line Test To Determine if Certificate is required
- Applicable only to **Class A & B** Water Districts/Associations
- Effective Period (07/01/2016 – 06/30/2018)
- Applies to “**water line extension or improvement project**”
- 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

HOUSE BILL 303

- 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)

HOUSE BILL 261

- Amends KRS 278.020 and KRS 278.021
- Reaction to Recent PSC Rulings
- New Sewer Facilities must provide bond or guarantee of reasonable operation for 1st five years
- No transfer of sewer facilities without evidence of financial integrity to continue service should acquirer fail
- Notice must be given to AG, DOW, local authorities at time of any application to abandon sewer utility
- Nothing in KRS 278.021 requires PSC to permit abandonment

HOUSE BILL 189

- Approval of AG/DLG and jurisdictional agency no longer required for amendments to interlocal agreements if:
 - Amendment is to add or remove a party to agreement
 - No substantive changes to agreement
- Specifies Docs to be sent to AG or DLG/SecState/County Clerk by all parties to the amended agreement
- Parties to ILA may specify manner of joining or leaving agreement, including approval of legislative body
- Legislative body of each entity must approve if Agreement silent

HOUSE BILL 309

- Allows for creation of public-private partnerships to finance capital projects/procure services
- Local governments may participate in partnerships (**WATER DISTRICTS ARE INELIGIBLE** – Municipal Utilities are eligible)
- Capital Project: the construction, reconstruction, acquisition, installation, and improvement of public infrastructure owned by a local government and that serves a public purpose of the local government
- Act establishes minimum requirements of public-private partnership agreement

HOUSE BILL 309

- Minimum requirements include:
 - Legislative body approval of any sale of property or lease to 3d party
 - Performance & Payment bonds
 - Local Government approval of plans and specs
 - Local Government inspection of project
 - Maintenance of Liability Insurance
 - Reimbursement to local government for any services provided
 - Policies & Procedures for termination
 - Detailed Description of duties

HOUSE BILL 309

- Requires Finance & Administration Cabinet to promulgate regs by 12/31/16 to establish criteria for using P³ arrangement
- Specifies the minimum requirements for a request for proposal for P³ proposal
- Establishes Kentucky Local Government Public-Private Partnership Board (11 Members)
- Board to review all P³ Agreements whose value exceeds 30% of the local government's general fund revenues
- Standard:
 - Agreement complies with minimum requirements;
 - Awarded by competitive negotiation on the basis of best value

OTHER ENACTED LEGISLATION

- HB 529 – Creates the Kentucky Water Resources Board
- HJR 152 – Directs DOW to meet with Corps of Engineers & Natural Resources Conservation Service
Re: procedures for developing water resources for agriculture

PSC PERSONNEL

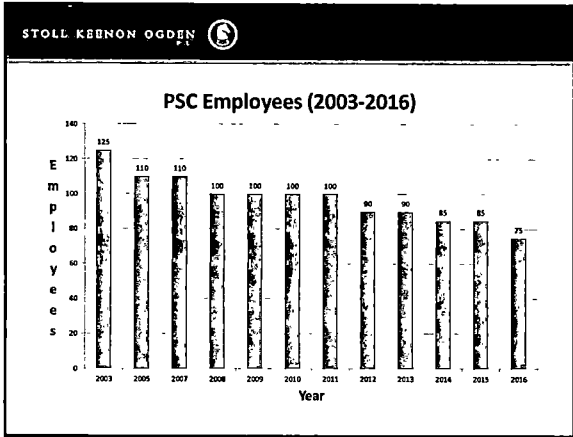
DEPARTURES

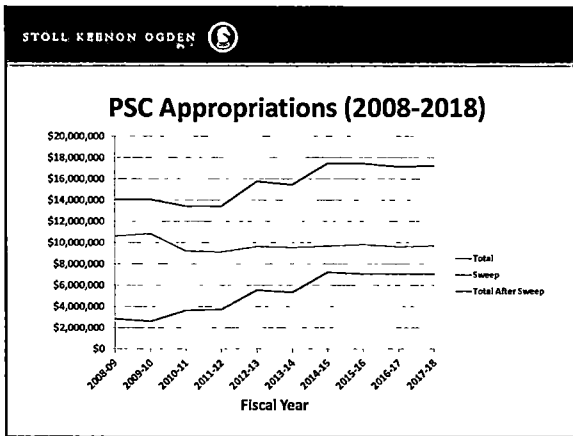
- David Armstrong (Chair)
- Jim Gardner (Chair/Vice Chair)
- Roger Thomas (Commissioner)
- Jeff Derouen (Executive Director)
- Linda Faulkner (Director, Filings Division)
- Brent Kirtley (Manager, Tariffs Branch)
- George Wakim (Mgr, Engineering H₂O Branch)

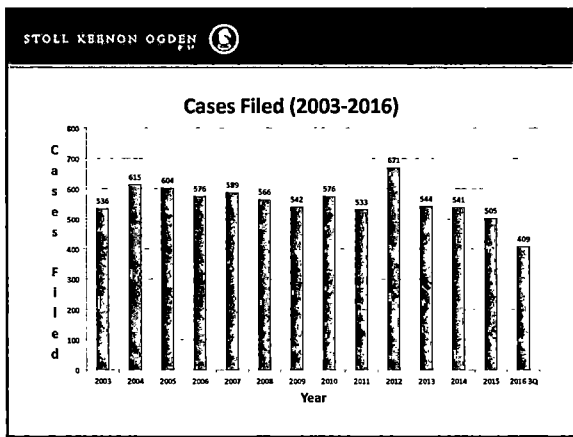
APPOINTMENTS

- Michael J. Schmitt - Chairman (Term ends 6/30/2019)
- Robert J. Cicero - Commissioner (Term ends 6/30/2020)
- Talina Mathews - Executive Director
- David Spenard – Principal Water Attorney
- Jason Pennell - Water Investigator

PSC FUNDING & ORGANIZATION





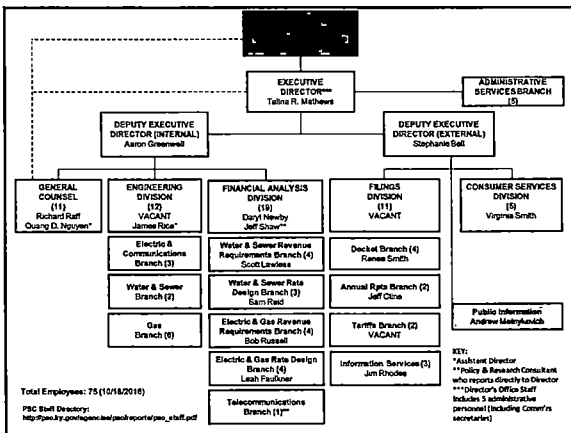


PSC ENGINEERING REORGANIZATION

- Engineer Staff transferred to other agencies within E&E Cabinet (10/15/2016)
- PSC to rely upon E&E Cabinet personnel for Engineering expertise/advice
- PSC seeking greater inter-agency cooperation
- Possible PSC-E&E Cabinet MOU/Executive Order Reorganizing PSC
- PSC to emphasize inspections and investigations

PSC ORGANIZATIONAL CHANGES

- Research Division Eliminated
- Financial Audits Branch Eliminated
- Management Audits Branch Eliminated
- Engineers Transferred to Other Agencies
- Meter Testing Lab Reduced to Part-time Technician
- GIS Personnel/Services Eliminated



ADAPTING TO THE NEW ENVIRONMENT: Part I

- Incorporate PSC Review Periods Into Planning Process
- Do not Wait Until Last Minute
- Alert PSC Staff to Timing Requirements
- More Comprehensive Application
 - Provide Historical Background
 - Provide Greater Narrative/Testimony of Utility Officials
 - Anticipate Requests for Information/Documents & Include

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
- Do Not Underestimate Importance of Public Notice

ADAPTING TO THE NEW ENVIRONMENT: Part III

- Request Deviations When Necessary
- Contact Potential Intervenors
 - Ascertain Their Positions
 - Explain Your Application/Requested Relief
- Check Periodically on Status of Proceeding
- Use Electronic Filing Procedures
- Take Advantage of Available Resources


**ADAPTING TO THE NEW ENVIRONMENT:
AVAILABLE RESOURCES**

- PSC Website (psc.ky.gov)
 - PSC Orders since 1980 **SEARCHABLE**
 - All Active Utility Tariffs **SEARCHABLE**
 - All Utility Tariff Filings since 2005 **SEARCHABLE**
 - Staff Opinions **SEARCHABLE**
 - Audits
 - Annual Reports since 1990
 - PSC Case Records Since 2005 **SEARCHABLE**
 - PSC Video Transcripts (Available online from 2011)
 - Listing of Daily Filings & Orders


**ADAPTING TO THE NEW ENVIRONMENT:
AVAILABLE RESOURCES**

- Statutes (<http://www.lrc.ky.gov/Statutes/index.aspx>)
- Regulations (<http://www.lrc.ky.gov/Statutes/index.aspx>)
- Compilation of Utility Laws App (<http://bit.ly/2cT2oVo>)
- PSC Staff Directory (http://psc.ky.gov/agencies/psc/reports/psc_staff.pdf)
- Kentucky Water Utility Law Twitter Feed (<https://twitter.com/gwuetcher>)
- Small Utilities Web Page (<http://smallutilities.ky.gov/>)
- PSC Regulations (<http://www.lrc.state.ky.us/kar/TITLE807.HTM>)

RATE ISSUES

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DEPRECIATION EXPENSE

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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

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

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)

METHODS FOR DETERMINING ASSET’S USEFUL LIFE

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

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

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

Depreciation Practices For Small Utilities

- National Ass'n of Regulatory Utility Commissioners (NARUC) Publication (Aug. 15,1979)
- Intended to address the needs of regulatory commissions to establish realistic depreciation rates for small H₂O utilities
- Provided in table format a range of average service lives then in use by H₂O utilities throughout the US for H₂O facilities designed & installed & maintained in accordance with good H₂O works practice

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.


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	8	8


PSC STAFF APPROACHES

- Utility's Useful lives are within NARUC Range – No Change (Engineer)
- Useful Lives Outside NARUC Range – Revise to Minimum Range (Engineer)
- Useful Lives Outside NARUC Range – Revise to Mid-Range (Engineer/Accountant)
- Useful Lives Outside NARUC Range – Revise to Max (Accountant)
- Useful Lives Within NARUC Range – Lives Revised to Longer/Maximum Period (Accountant)

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RESPONSE TO STAFF RECOMMENDATION

- Only 1 Utility has contested recommendation
- 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 will be used to establish useful lives
- 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
2016-00177	\$ 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%

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

TYPES OF SUPPORTING EVIDENCE

- Past PSC Treatment of Depreciation Expense
- Depreciation Study
 - Adequate Records?
 - Potential Cost
- Engineer Testimony
 - Sworn Affidavit
 - Greater Weight

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

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

**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?

**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

**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)

DEPRECIATION: SUMMARY

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

DEPRECIATION: SUMMARY

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

EMPLOYEE COMPENSATION EXPENSE

EMPLOYMENT COMPENSATION

- Employee Compensation
 - Wages/Salaries
 - Health Insurance
 - Special Allowances
- Accepted with limited PSC review
- PSC considered expenditures controlled by competitive forces
- Scope of Review: Is compensation excessive?

EMPLOYMENT 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

**EMPLOYMENT 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

**EMPLOYMENT 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."

**EMPLOYMENT 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 subsequently granted rehearing to consider AG's objections

**EMPLOYMENT COMPENSATION:
SUPPORTING COMPENSATION PACKAGE**

- PSC will more closely review Wage/Salary & Fringe Benefits packages
- Include support in Applications for Rate Adjustment
- Compare current compensation packages with other utilities and general community
 - KRWA Salary Survey
 - Kentucky League of Cities' Wage and Salary Survey
 - Bureau of Labor Statistics
 - PSC Annual Reports

**EMPLOYMENT COMPENSATION:
SUPPORTING COMPENSATION PACKAGE**

- Support for Wage/Salary Increases
 - Consumer Price Index
 - Bureau of Labor Statistics
- Identify other factors that affect compensation packages
 - Utility's Location
 - Local Labor Pool
- Annual Increases: Provide the basis for any percentage increases that are greater than most employees

**EMPLOYMENT COMPENSATION:
SUPPORTING COMPENSATION PACKAGE**

- Document Wage/Benefit Decisions
 - Bd Minutes should reflect Bd's reasoning for increases
 - Specific, detailed reasons preferred over general
- Fringe Benefits
 - Use State Government Fringe Benefits As Baseline
 - Explain the need for benefits packages that exceed the baseline
 - Explain any fringe benefits (e.g., health insurance) that are provided to Bd Members
- Consider Implementing Evaluation System to provide better support for selective wage/salary increases

REVENUE REQUIREMENT METHODOLOGY

Current PSC Methodology

Revenue Requirement =
O&M Expenses + Depreciation +
Debt Service Coverage

Debt Service Coverage = 1.20 x (5-YR
Average Interest + Principal Payments)

Current PSC Methodology

- Criticisms of Methodology
 - No historical basis for methodology
 - Produces excessive revenue requirement
 - Bond coverages do not consider depreciation
 - Double Recovery of Debt-Financed Assets
 - Many Water Utilities are rejecting Methodology & requesting lower revenues

**ALTERNATIVE METHODOLOGY:
CASH NEEDS**

- Referenced in PSC Staff Report in Case No. 2012-00537
- Methodology Provides:
 - No additional working capital (1.0x, NOT 1.2x)
 - DSC = 5-YR Average of Interest + Principal Payments
 - **Lower Revenue Requirement Results**
- Calculation appears in every PSC Staff Report


**ALTERNATIVE METHODOLOGY:
CASH NEEDS**

The City Bond Indenture requires the City Council to ensure that the annual net revenue for the year will be at least 1.25 percent of the average annual DC bond issue and that revenue covering the debt on all outstanding revenue projects at any time shall not be less than the DC bonds. The DSC will be calculated on the basis of the 5-year average of the average net revenue for the period 2007-2011. The DSC will be calculated on the basis of the average net revenue for the period 2007-2011. The DSC will be calculated on the basis of the average net revenue for the period 2007-2011. The DSC will be calculated on the basis of the average net revenue for the period 2007-2011.


	2010 Actual	2011 Actual	2012 Actual	2013 Actual	2014 Actual	2015 Actual	2016 Actual
General Revenue Requirement	\$ 1,444,517	\$ 1,397,889					
Less: Pre-Paid Charges and Maintenance Expenses	(214,385)	(219,385)					
Plus: Other Revenue	(14,878)	(14,878)					
Less: Net Cash Encumbered							
Net Revenue	\$ 1,215,254	\$ 1,163,626					
DC Bonds	268,897	268,897					
Other Average Annual Debt Payment	270,394	270,394					
DSC Ratio	4.53	4.33					

**ALTERNATIVE METHODOLOGY:
CASH NEEDS**


- PSC Staff: Alternative method will produce sufficient revenue for water utility to meet its expenses & debt service payments AND satisfy all coverage requirements of bond covenants

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WATER DISTRICT COMMISSIONERS

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APPOINTMENT OF WATER DISTRICT COMMISSIONERS

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To all Water Districts

Kearney law requests a Water District to please the Public Service Commission when a vacancy occurs on the Water District's Board of Commissioners. Water Districts are also required to notify the Public Service Commission when an appointment has been made to fill a vacancy on the Water District's Board of Commissioners.

KRS 14.020 (9) (a) and (b) govern the notifications that a Water District must send to the Public Service Commission and provide that:


(a) Within forty (40) days of the occurrence of a vacancy on its board of commissioners resulting from the expiration of a term or its death, resignation, or removal or the incumbent, a water district shall notify by writing the Public Service Commission of the existence of the vacancy. The notice shall include the name of the commissioner who last held the position and the date on which the unexpired term will end.

(b) Within forty (40) days of the appointment of a commissioner and the appropriate local county approval of said appointment, a water district shall notify the Public Service Commission of the appointment. The notice shall include the appointed person's name and the date of the expiration of his or her term.

Please be advised of these statutory requirements and your obligation to provide written notice to the Public Service Commission. All notices should be addressed to Tamera Matthews, Executive Director. Please also be advised that, pursuant to KRS 14.020(1) if a vacancy is not filled within 90 days of the vacancy occurring, the responsibility of filling the vacancy falls to the Public Service Commission.


If you have any questions or need additional information, please contact J. E. B. Pharcy, Staff Attorney.

Patrons...

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APPOINTMENT OF COMMISSIONERS

- KRS 74.020(1): Commissioner “shall be appointed by the county judge/executive with **the approval of the fiscal court**”
- If appointment and approval does not occur within 90 days of vacancy, local officials **forfeit authority** to fill the vacancy
- Vacancy occurs:
 - Death
 - Resignation
 - Removal
 - Expiration of Term

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APPOINTMENT OF COMMISSIONERS

- KRS 74.020(4): Vacancy shall be filled by the PSC if, 90 days following the vacancy, it has not been filled
- PSC Procedure:
 - Initiate Formal Proceeding
 - Notify County Judge/Fiscal Court/Water District
 - Request Nominations
 - Review/Investigate Nominees
 - Make Appointment

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APPOINTMENT OF COMMISSIONERS

- PSC Review:
 - Questionnaire to Each Nominee
 - Education
 - Business/Government/Utility Experience
 - Business Dealings with Water District
 - Family Members Affiliated with Water District
 - Legal Qualifications (Residence, Incompatible Offices)
 - Water Commissioner Training
 - Attendance at Water District Board Meetings
 - Background Check
 - Endorsements

APPOINTMENT OF COMMISSIONERS


- PSC Deference to Local Officials
 - PSC will defer to Local Officials where County Judge/Fiscal Court in agreement
 - Rationale: Local officials have a better understanding of the candidates’ qualifications and water district’s needs and are directly accountable to voters
 - Exception: The presence of “circumstances that raise clear concerns about an agreed candidate’s qualifications”
 - PSC Less likely to defer to local officials if no agreement or silence

**APPOINTMENT OF COMMISSIONERS:
REQUIRED NOTICE OF VACANCY**

- KRS 65.008
 - Requires district to notify appointing authority at least **sixty (60) days before the expiration of the term of office** of an appointed member of governing body
- KRS 74.020(9)
 - Requires written notice to PSC of existence of **vacancy no later than 30 days after occurrence of vacancy**
 - Requires written notice to PSC that vacancy has been filled no later than **30 days after vacancy filled**


**APPOINTMENT OF COMMISSIONERS:
RECENT PSC CASES**

- 2015: 3 Cases Involving WD Commissioner Vacancies
 - 2015-00305 (Adair County Water District)
 - 2015-00313 (Jessamine County Water District No. 1)
 - 2015-00352 (Western Pulaski County Water District)
- 2015-00305
 - Newly-elected County Judge alleged improper appointment (appoint occurred more than 90 days after vacancy)
 - PSC investigated/invalidated appointment
 - Filled vacancy after receiving 8 nominations
- Other Cases: WD failed to notify County Judge of vacancy


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AVOIDING APPOINTMENT PROBLEMS

- Maintain records Re: term ending dates
- Encourage the Judge-Executive to Note Term-ending date on appointment order
- Provide at Least 60 Days' Notice to County Judge
- Advise Fiscal Court of the Consequences of Failure to fill within 90 days of vacancy
- Timely Notification to PSC
- Request PSC to ratify any post-90 day appointment

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COMMISSIONER/DIRECTOR LIABILITY FOR REGULATORY VIOLATIONS

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COMMISSIONER/DIRECTOR LIABILITY

- Recent Trend: WD commissioners held personally liable for violations of PSC Statutes/Regs
- Last 4 of 5 proceedings involving non-operational issues – Commissioners ordered to show cause
 - 2014-00400 – Construction & Debt issued w/o PSC OK
 - 2015-00155 – Debt issued without PSC OK
 - 2015-00353 – Debt issued without PSC OK
 - 2016-00338 – Debt issued without PSC OK
- Commissioners threaten with assessment of maximum penalty (\$2,500)

COMMISSIONER/DIRECTOR LIABILITY


- Based upon KRS 74.080: Bd of Com'rs "shall control and manage the affairs of the district"
- Commissioners have "agreed" to attend Water Training Programs ILO Penalties
 - 2014-00400: 12 hours annually for remaining term
 - 2015-00155: 12 hours annually for remaining term
 - 2015-00353: Ex-com'rs agree to attend new com'rs training plus 5 hours in first year if appointed again
- Same Legal Theory May Be Applied to Water Association Directors

LEGAL REPRESENTATION

- Should Commissioners retain legal counsel?
 - Maximum Penalty: \$2,500 for each offense
 - Possible Prison Sentence of up to 6 months
- Who should represent Commissioner?
 - District/Association Counsel
 - Separate Counsel
- Potential Conflicts of Interest
- Who Assumes Cost of Legal Representation?


FINES AND PENALTIES

- Who should pay penalties?
- Commissioner/Director
 - Individual Responsibility/Accountability
 - If no liability, no incentive to perform duties well
- Utility
 - Commissioner Acting To Further Utility Interests
 - Commissioner Acting Within Scope of Duties
 - Good Faith
 - Liability Discourages Qualified From Serving

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**INDEMNIFICATION:
DIRECTORS AND OFFICERS INSURANCE**

- Insurance Coverage for Defense Costs, Settlements, & Judgments
- Issues to Consider:
 - WD's Legal Authority to Purchase
 - Cost of Insurance
 - Coverage/Limits
 - Recovery in Rate Case
 - KRS 74.020(3)/Ethics Code Concerns

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**INDEMNIFICATION:
UTILITY INDEMNIFICATION POLICY**

- Sets Forth Utility Responsibility for Costs
- KRS 74.020(3)/Ethics Code Concerns
 - Written Policy Necessary **Prior to Incident**
- Contents:
 - Legal representation By Whom
 - Notice provisions
 - Veto provisions
 - Waiver of Conflicts
 - Coverage: Penalties, legal costs


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**INDEMNIFICATION:
UTILITY INDEMNIFICATION POLICY**

- Possible Exclusions
 - Water District Commissioner Removal Proceedings
 - Intentional Acts/Lack of Good Faith
 - Outside Scope of Official Business
- Recovery of Expenses Through Rates


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WATER COMMISSIONER TRAINING

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WATER COMMISSIONER TRAINING

- Prior to 2010: No mandatory training
- 1998: KRS 74.020 revised to encourage training
 - Maximum Annual Salary increased from \$3,600 to \$6,000 if 6 hours of accredited training attended in year
 - Fiscal Court Approval required for increase
 - PSC accredited Training
- 2010: New Commissioner Training Mandated

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"NEW" WATER COMMISSIONER TRAINING

- KRS 74.020(8)
 - PSC directed to develop program for newly appointed commissioners
 - "Within twelve (12) months of his or her initial appointment, each commissioner shall complete the program of instruction"
 - Failure to complete: Forfeiture of Office
- Initial Interpretation: Training Requirement applied only to Commissioners appointed to first term after 7/14/2010


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“NEW” WATER COMMISSIONER TRAINING

- New Interpretation
 - PSC Staff Opinion 2014-017: Requirement applies to any Commissioner appointed after 7/15/2010 unless in office on 7/14/2010 & continuously serving since then
 - PSC adopts in Case No. 2015-00313 (11/17/2015)
 - Basis: Intent of Statutory Revision that WD Commissioners Be Adequately Trained
- Consistent with recent PSC efforts to aggressively promote water training program

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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

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

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

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

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?


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?

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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QUESTIONS?

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

gerald.wuetcher@skofirm.com
859-231-3017
