COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:	**)**	
	)	
NOTICE OF ADJUSTMENT OF THE RATES OF	**)**	**CASE NO. 2004-00103**
KENTUCKY-AMERICAN WATER COMPANY	**)**	
EFFECTIVE ON AND AFTER MAY 30, 2004	**)**	

RESPONSE OF KENTUCKY-AMERICAN WATER COMPANY TO THE LEXINGTON-FAYETTE URBAN COUNTY GOVERNMENT'S APPLICATION FOR REHEARING

The Lexington-Fayette Urban County Government ("LFUCG") has asked the Public Service Commission ("Commission") to reduce its contribution to Kentucky-American Water Company's ("Kentucky American Water") cost of service from public fire protection revenues by $229,221.[1]

The house of cards upon which the LFUCG builds this request is that (1) the cost of service study in the record shows an allocation of 4.0% of public fire protection revenue to the cost of service, (2) this is the only evidence in the record on an appropriate allocation of the cost of service to public fire protection, (3) the only evidence in the record must be believed and adhered to by the Commission, and (4) the Commission must be consistent in this case with its conclusion in Case No. 2000-120 in assigning a portion of the cost of service to public fire protection.

The structure of the LFUCG's house of cards simply cannot withstand careful analysis or rational thought. First, the cost of service study presented by Kentucky American Water in this case was generated for Case No. 2000-120. Schedule A to the LFUCG's Application for

[1] LFUCG's Application for Rehearing, p. 7.

Rehearing shows that Kentucky American Water advocated no change in the percentage contribution of public fire protection to the cost of service in that case. Kentucky American Water proposed sales of $43,801,334 with public fire protection producing $1,736,908, or 4%. The effect of the Commission's decision and its recommended tariff structure resulted in public fire protection revenues contributing 4.2% of the total allowed revenues.[2] The LFUCG was a party in Case No. 2000-120 and did not complain therein about fire protection revenues contributing 4.2% of the total revenues.

Herein the LFUCG asserts that the only evidence in the record is that fire protection services should contribute 4% of the revenues and that the failure of the Commission to believe that evidence is unreasonable and arbitrary.[3] That assertion ignores several principles of ratemaking in the Commonwealth of Kentucky. First, the relevant question is whether or not the Commission's determination is "unreasonable or unlawful" as set forth in KRS § 278.430. The Kentucky Supreme Court has defined "unreasonable" in this context as follows:

> "In regard to the orders of the Commission, the obligation of the court is to determine whether the protestants have shown by 'clear and satisfactory evidence' from the record that the Commission orders are unlawful or unreasonable. KRS 278.430. The orders can be found unreasonable only if it is determined that the evidence presented leaves no room for difference of opinion among reasonable minds."[4]

It is axiomatic that the Commission, acting in a quasi-legislative and judicial capacity in ratemaking proceedings, is not legally bound to accept and believe the only evidence that may be offered on a particular subject. The Kentucky Court of Appeals has spoken directly on the subject in Energy Regulatory Commission v. Kentucky Power Company, 605 S.W.2d 46 (Ky. App. 1980). Therein the Energy Regulatory Commission (now the Public Service Commission)

[2] $1,736,908 divided by $41,284,834.
[3] LFUCG's Application, p. 5.
[4] Kentucky Industrial Utility Customers, Inc. v. Kentucky Utilities Company, 983 S.W.2d 493, 499 (Ky. 1998).

denied Kentucky Power Company a certificate of public convenience and necessity and authority to borrow money to purchase an interest in an Indiana electric generating plant. The Franklin Circuit Court reversed the Commission's decision. The Court of Appeals reversed the decision of the Franklin Circuit Court and, in remanding the matter to the Commission for the finding of specific evidentiary facts, chose to "clarify the law and thereby prevent, if possible, the necessity of further review after remand."[5]

In clarifying the law, the Court of Appeals pointed out that the scope of judicial review of administrative determinations by the Public Service Commission is very limited and materially different from other administrative or quasi-judicial agencies. In speaking directly to the issue raised by the LFUCG herein, the Court of Appeals said:

> "Repeated references are made to uncontradicted evidence and to the fact that no evidence to the contrary was introduced by the Commission. The circuit judge ruled that the Commission was required to come forward with an affirmative case whenever the applicant makes what might be termed a prima facie case before the agency. We believe the circuit court committed reversible error because it thereby would shift the burden of proof from the applicant to the commission. This would place the commission in an adversary position. Standing alone, unimpeached, unexplained and unrebutted evidence may or may not be so persuasive that it would be clearly unreasonable for the board to be convinced by it. [Citation omitted]. There are some questions and circumstances in which no evidence is required to support a negative finding.
>
> The Commission had no duty to refute evidence submitted to it by an applicant who had the burden of proof."[6]

Where there is uncontradicted evidence in the record, the Commission, acting as a quasi-judicial and legislative body in making rates, must have a zone of reasonableness in order to properly perform its functions. It has exercised its discretion for cost of service studies in cases such as An Adjustment of General Rates of Delta Natural Gas Company, Inc., Case No. 97-066,

[5] Energy Regulatory Commission v. Kentucky Power Company, 605 S.W.2d 46, 49 (Ky. App. 1980).
[6] Id., p. 50.

Order dated December 8, 1997. In commenting about the applicant's cost of service study presented in that case, the Commission said:

> "While recognizing that subjective assumptions are required to prepare cost-of-service studies, the Commission is of the opinion that such studies should be conducted in strict adherence to accepted and stated methodologies.
>
> Having reviewed Delta's cost-of-service study, the Commission finds that it should not be given controlling weight in the establishment of Delta's rate design. The Commission is not convinced that the average and peak methodology has sufficient reliability to warrant it the Commission's complete reliance. Absent the use of another methodology to collaborate the average and peak methodology's results, preferably the zero-intercept method, this Commission will not give conclusive weight to studies using such methodology. The Commission holds the same position with respect to the AG's cost-of-service study."[7]

Cost of service studies are experts' opinions and the law is clear that the Commission is not obligated to accept those opinions as an irrefutable finding of fact.

Lastly, the LFUCG has asked the Commission to establish a public fire protection rate for fire hydrants owned by the LFUCG. Kentucky American Water made its position very clear in its response to the LFUCG's Second Request for Information, Item 1, when it said, "The Company wishes to continue ownership of the fire hydrants, but is will to discuss the various cost of service methods used in other jurisdictions with the LFUCG." No such discussion ensued which certainly suggests that the LFUCG was not interested in pursuing fundamental allocation questions in the cost of service study. Kentucky American Water is opposed to the concept of the LFUCG owning and maintaining public fire hydrants attached to the company's transmission and distribution system. If the LFUCG genuinely believes that the allocation of fire protection services by the Commission should change, it had every opportunity to and was invited by Kentucky American Water to present alternative proposals in this case.

[7] Order, pp. 23- 24.

Having failed to do so it should not now be heard to effectively do the same by requesting a rehearing. Indeed, the LFUCG's request would result in an inappropriate allocation of the cost of providing public fire protection services and the development of a tariff without a sufficient hearing, notice and evidence on the subject and might result in the LFUCG's ownership of attachments to Kentucky American Water's system.

For all of these reasons, the LFUCG's request should be denied.

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CERTIFICATION

This is to certify that a true and accurate copy of the foregoing has been electronically transmitted to the Public Service Commission on March 28, 2005; that the Public Service Commission and other parties participating by electronic means have been notified of such electronic transmission; that, on March 29, 2005, the original and one (1) copy in paper medium will be hand-delivered to the Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601; and that on March 28, 2005, one (1) copy in paper medium will be served upon the following via U.S. Mail:

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