

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ADJUSTMENT OF RATES OF KENTUCKY-) CASE NO. 2004-00103
AMERICAN WATER COMPANY)

**LEXINGTON-FAYETTE URBAN COUNTY
GOVERNMENT'S APPLICATION FOR REHEARING**

Comes now the Lexington-Fayette Urban County Government (the "LFUCG"), by counsel, and pursuant to KRS 278.400 applies to the Commission for rehearing of its Order of February 28, 2005 in the above-styled case (the "Order").

In particular, the LFUCG seeks rehearing of the Commission's determination with respect to the allocation of an across-the-board increase to public fire protection rates in complete contradiction to the uncontested cost of service information in this case, which clearly demonstrates that such rates already exceeded the cost of providing such service even without the rate increase. It also requests that the Commission establish a tariff for fire hydrants that are owned by governmental entities (including the LFUCG) that is equal to fifty seven percent (57%) of the current public fire hydrant rate, as further argued below.

I. The Public Fire Hydrant Rate Should Not Have Been Raised

Kentucky-American Water Company's cost of service study (the "Study"), which is the only substantive evidence of record in this case regarding the allocation of costs among the customers, shows that even before the across-the-board rate increase was awarded by the Commission, public fire hydrant rates were already subsidizing other ratepayers. Increasing the subsidy to other customers from public fire protection rates is contrary to **all** of the evidence of record in this proceeding, inconsistent with the principles and findings that were relied upon by the Commission in resolving other issues in this proceeding, and is also barred by the doctrine of collateral estoppel (issue preclusion), as established by the Commission in Case No. 2002-00317.

A. The Public Fire Hydrant Rates are Contrary to the Uncontested Evidence of Record in this Case

The Commission has to date rejected the LFUCG's argument that public fire protection rates should be determined according to the Study provided by Kentucky-American Water Company ("Kentucky-American" or the "company") in this proceeding¹, and instead awarded an across-the-board increase to all classes of customers, regardless of each class's respective contribution to its cost of service. This is contrary to the long-standing practice of the Commission to rely upon cost of service studies to support the allocation of the rates among the

¹ Contrary to the Commission's description (see Order at page 76), the cost of service study was not a "previous" cost of service study. It was submitted by the company in this case as well, and defended by the company in its responses to data requests as still being accurate. No party argued that the study was no longer valid.

various customer classes. Indeed, in this very case, the Commission accepted the Attorney General's argument that the Northern Division's rates should not be increased because there was no cost of service study pertaining to them. See Order at pages 75-76. It is even more indefensible to increase public fire protection rates in this proceeding when the existing rate was already above its cost of service. See Section I(B), infra, for a detailed argument on this issue.

Moreover, the Commission rejected Kentucky-American's attempt to provide a credit to its low-income customers because such free or reduced cost service is basically unreasonable as a transfer of income from other customers. Order at page 84. It is equally, if not more unreasonable, to have essentially the same type of transfer taking place with respect to the percentage of the portion of the public fire hydrant rate that is above four percent – which results in a transfer of a far greater amount being born by one customer class (and in this instance essentially one customer, the LFUCG).

The Commission apparently misunderstood the actual argument made by the LFUCG in its Brief, and erroneously stated in the Order that the LFUCG asserts “public-owned fire hydrants **generate** only 4 percent of the total revenue from rates.” See Order at pp. 76-77 (emphasis added).² It then compounded its error by finding that even though the company's Study served

² It is perhaps implied in the Commission's finding on this issue that expert testimony must support an argument based upon evidence already in the record. If this is actually what the Commission meant it should reconsider its decision, as there exists no regulation regarding such a requirement, nor was the LFUCG provided any other advance notification that such a requirement would be imposed in this case.

as the basis for the LFUCG's **actual argument**, there was no evidence in the record to support it. See Id.

The LFUCG's actual argument, which was that public fire protection **should be responsible** for four percent (4%) of the Company's revenues, was based entirely on the Study³ -- **which was the only substantive cost allocation evidence of record presented in this proceeding.**⁴ In fact, in Case No. 2000-00120, public fire protection returned significantly more than four percent (4%) of the company's revenues, thus Kentucky-American proposed that public fire protection bear no portion of any increase to be granted in that case. This argument was concurred with by the Attorney General and accepted by the Commission, which resulted in no increase to public fire hydrant rates despite a significant increase to Kentucky-American's revenues, and as a result began to move the public fire hydrant rate towards its cost of service.⁵

The distinction is crucial. The Commission's current formulation does not actually deal with cost of service at all, but with a snapshot of the revenues returned at a given time. The LFUCG proposal was based on the **cost of service** for fire protection as determined by Kentucky-American -- not the LFUCG. The LFUCG should not be consigned to a permanent position of subsidizing other ratepayers, and the decision of the Commission must at least serve to move such rates towards the cost of providing the service -- and not to increase the public fire hydrant class's subsidy to other ratepayers. To continue to impose rate

³ See Exhibit 36, page 6 of 40, attached hereto as LFUCG Exhibit No. 1.

⁵ Case No. 2000-00120, Order of November 27, 2000 at page 68.

increases that require the LFUCG, as the payer of some ninety-three percent (93%) of public fire rates, to subsidize other customers is unreasonable, arbitrary and contrary to all of the evidence of record in this case.

The Study **was the only cost assignment evidence filed by any party**. It shows that the cost of service for public fire protection is equal to four percent (4%) of sales revenues.⁶ No party filed any evidence or raised any argument that the Study was not accurate. In an abundance of caution, the LFUCG even questioned the company as to why a new study was not performed, or why the Study was not at least updated for this case. The consistent response of Kentucky-American, which went unchallenged, was that no material change in cost causation had occurred since Case No. 2000-00120 that would require a new study, or even an update to the existing study.⁷ The Study was not criticized by any party to this proceeding, let alone updated or modified.

The LFUCG also asked Kentucky-American why it proposed an across-the-board increase for public fire rates when such an increase **would result in public fire protection continuing to pay more than its cost of service as determined by the company's own cost of service study**. The response (which was based upon the results of the Study). See Kentucky-American's Response to LFUCG's Second Requests for Information, Question No. 2(c). However, the Commission must measure the reasonableness of this decision

⁶ See LFUCG Exhibit No. 1.

⁷ See Kentucky-American's Responses to LFUCG's First Request for Information, Question No.'s 8, 10, 11, 24; Kentucky-American's Response to LFUCG's Second Requests for Information, Question No. 16.

against the dramatic financial impact it has on the LFUCG, and the fact that the LFUCG is already subsidizing the other ratepayers.

B. The LFUCG Subsidized the Other Ratepayers Even Before the Award of the Additional Rate Increase

The Commission found that Kentucky-American was entitled to recover \$41,922,001 in water sales revenues under the approved rates, and also granted an additional \$3,611,302 in revenues as a result of this case. See Order at pages 68 and 75. Assuming that all new revenues are sales revenues, the total water sales revenues allowed are \$45,533,303. The Study indicates that the public fire protection's cost of service is four percent (4%) of water sales revenues.⁸ This would equal a cost-based revenue requirement from public fire hydrants of \$1,821,332.⁹ There is no other evidence of record as to the cost of service for public fire hydrants.

Kentucky-American reported that revenues from public fire hydrants for the twelve months ended July 31, 2005 would be \$1,845,303 under current rates.¹⁰ Thus, **even without any rate increase**, and using a number of hydrants that is significantly below the number forecasted to be in place during the forecast period, public fire protection would still return more than its fair cost-based revenue.

⁸ See LFUCG Exhibit No. 1.

⁹ \$45,533,303 multiplied by 4%.

¹⁰ See KAW_SAPP_EX37M_091504 at page 1 of 27, attached hereto as LFUCG Exhibit No. 2.

Under the approved rates (and assuming the 6610 public fire hydrants that Kentucky-American stated will be in place in November, 2005¹¹), public fire hydrants will return revenue in the amount of \$2,068,071.¹² This will result in a collection from public fire hydrants of \$246,739¹³ above the revenue requirement found to be appropriate under the company's cost of service study. The LFUCG pays for 6143 of these hydrants (92.9 percent) and therefore contributes \$229,221¹⁴ per year to subsidize other customers.¹⁵

Thus, the subsidy continues – and it is not, as suggested by Kentucky-American “reasonable.” By way of contrast, Kentucky-American's more than 100,000 other customers are only receiving a *de minimis* subsidy (approximately 20 cents per month) as a result of imposing these excessive costs on essentially one customer – the LFUCG. This is arbitrary and unreasonable, and the Commission should be lessening this subsidy rather than continuing and expanding it.

The LFUCG therefore respectfully requests that the Commission assign only the fair cost of service to public fire protection as required by the lone

¹¹ See Attachment to Kentucky-American's Response to LFUCG's First Requests for Information, Question 42, page 1 of 2.

¹² 6610 hydrants multiplied by \$312.87 per hydrant

¹³ \$2,068,071 minus \$1,821,332

¹⁴ \$246,739 multiplied by 92.9%

¹⁵ A similar analysis, using only evidence of record and simple mathematical operations, was presented in the LFUCG's Brief in this case. This additional analysis is provided to demonstrate that a serious and substantial subsidy continues even though the Commission did not grant the company all of the rate increase requested. All numbers in this analysis are verifiable from the record or the result of elementary mathematical computations.

substantive evidence of record in this case on this issue -- Kentucky-American's cost of service study. However, because the LFUCG also recognizes that the Commission considers rate continuity and stability to be important factors in rate design (as well as the fact that it agreed to the allocation in Case No. 2000-00120), it modifies and lessens this request by limiting it to the rates established in Case No. 2000-00120, rather than a reduction to the rate established in that case. Thus the rate per public fire hydrant should continue to be \$287.52 per annum. For 6610 hydrants, this would result in annual revenues of \$1,900,507.¹⁶

Although this still exceeds the revenue requirement for public fire protection as established by the Study¹⁷ by more than \$79,000 per annum, it will move public fire protection towards the actual and equitable cost of service without unduly prejudicing other customers. This is a fair and balanced approach that fairly recognizes the interests of all parties.

C. The Doctrine of Collateral Estoppel As Applied by the Commission Precludes the Parties from Contesting the Cost of Service Study

The doctrine of collateral estoppel also requires the Commission to reverse the increase to public fire hydrant rates, as Kentucky-American failed to introduce a different cost of service study, or supplement or modify the filed study. The company, the Attorney General, and the LFUCG were all parties to Case No. 2000-00120. Kentucky-American initially presented the Study as part of that case. It also recommended that there should be no increase to public fire

¹⁶ 6610 hydrants multiplied by \$287.52

¹⁷ \$1,181,332

protection rates this class was returning more than its cost of service. The Commission accepted this recommendation without challenge from any party, and indeed with the agreement of the Attorney General.¹⁸

The same cost of service study was filed in this proceeding. Kentucky-American stated for the record in this case that no material changes in cost causation had occurred since Case No. 2000-00120.¹⁹ No party disputed this claim.

In Case No. 2002-00317, the Commission stated the basis for issue preclusion in an administrative proceeding:²⁰

Issue preclusion bars further litigation when the issues in the two proceedings are the same, the adjudicator in the previous proceeding reached a final decision or judgment on the merits of the case, the estopped party had a fair opportunity to litigate the issue, and the issue in the prior action was necessary to the adjudicator's final decision. Newman v. Newman, Ky., 451 S.W. 2d 417 (1970).²¹

All of these elements are present. The issue in both Case No. 2000-00120 and this proceeding was the appropriate allocation of costs to public fire protection. The Commission reached a final decision on the merits of Case No. 2000-00120 and this issue, and this issue was necessary to the Commission's final decision in that case. All of the parties had the opportunity to fully and fairly litigate this issue.

¹⁸ Case No. 2000-00120, Order of November 27, 2000 at page 68.

¹⁹ See Kentucky-American's Response to LFUCG's Second Requests for Information, Question No. 16.

²⁰ See, Case No. 2002-00317, Order of October 16, 2002, at pp. 7-10.

²¹ Id. at page 8.

In both cases, the company filed a cost of service study indicating that public fire protection should only be responsible for four percent (4%) of sales revenues. In both cases, revenue recovery from fire protection exceeds that four percent (4%) cost, even without any increase to public fire protection rates. In Case No. 2000-00120 the Commission determined that no rate increase to public fire protection was appropriate -- under precisely the same set of conditions that exist in this case.

In the immediate case, the company recommends the same cost of service allocation; as noted above, it has admitted that there are no material changes to the Study that would require even an update. Public fire protection revenue again exceeds its rate of return even if no increase is granted. No change of circumstance has been shown that would prevent issue preclusion from applying. Because all of the requirements of issue preclusion, as previously stated by the Commission, have clearly been met, there is no basis for a different result on this issue in this proceeding and the public fire protection rate should not be increased.

II. Burden of Proof; Allocation to Other Customers

In his Reply Brief, the Attorney General objected to the LFUCG's recommendation regarding public fire rates because the LFUCG (for some unstated reason) bore the burden of proof with respect to this proposal and because it did not recommend how these costs would otherwise be recovered. For these reasons, the Attorney General recommended that the LFUCG be forced

to continue to subsidize other customers. See Attorney General's Reply Brief at page 18.

The Attorney General's argument is noteworthy in that it did not dispute the subsidy, or the cost of serving public fire protection. His assertion that the LFUCG bears the burden of proving that it is entitled to a fair rate for service is completely without foundation. Kentucky-American bears the burden of justifying its proposed rates, including the allocation of the revenue requirement to the classes. See KRS 278.190(3)(stating that the burden to show that an increased rate or charge is just and reasonable is on the utility that proposes an increase). Kentucky-American proposed an across-the-board increase despite the fact that none of its own evidence supported such a proposal. However, even if the LFUCG **did** bear the burden of its proposal, it has more than met that burden through the undisputed evidence of record.

The LFUCG has the right and duty to point out that a proposed rate is unfair to it. As the taxpayers of the LFUCG must ultimately bear the cost of these rates, they should not be required to subsidize residents of other jurisdictions. Indeed, the Attorney General has opposed such subsidies on other issues in this proceeding, including a minimal subsidy that would be borne by other ratepayers to help the most disadvantaged of Kentucky-American's customers.²²

²² The Attorney General also objected to "this type of rate design spot adjustment", without any citation to legal authority. See Attorney General Reply Brief at page 18. However, the Attorney General himself supported exactly such "rate design spot adjustments" in his objection to the low-income discount proposal and to the company's proposal for Northern District rates.

Finally, the Attorney General has already endorsed an across-the-board increase for all customers, regardless of the cost of serving those customers. Therefore he should have no objection to the costs that have unfairly been imposed on the LFUCG and the public fire hydrants customers being recovered in a similar manner from the remaining ratepayers, in that he has made no effort to determine a fair cost based mechanism for allocating such costs.

Under the LFUCG's request, other customers will still continue to be subsidized by the LFUCG (albeit to a lesser extent than under the rates approved in the Order), and no customer has the right to complain that they are not being subsidized enough by the LFUCG or have this serve as a basis for complaint by the Attorney General.

III. The Commission Should Establish a Rate for Public Fire Hydrants Owned By the Public Entity

The LFUCG requested that the Commission establish a rate for public fire hydrants owned by the LFUCG so that the LFUCG can properly evaluate whether to continue the current practice of allowing Kentucky-American to purchase hydrants and charge a return and taxes on the hydrant cost.²³ The company has already stated that forty-three percent (43%) of the hydrant charge is related to such return and taxes, and there is no reason not to establish a rate for LFUCG

Therefore, his objection to the LFUCG public fire hydrant proposal on this ground is inconsistent with his position on other "rate design spot adjustments".

²³ See LFUCG Brief at pp. 8-9.

hydrants at fifty seven percent (57%) of the current rate for public fire hydrants.²⁴

The Order fails to mention this issue and the LFUCG respectfully requests that the Commission order Kentucky-American file a tariff for government-owned public fire hydrants to be served at a rate equal to fifty seven percent (57%) of the rate set for hydrants owned by the company.

IV. Conclusion

The LFUCG respectfully requests that the Commission grant rehearing on the limited issues raised herein, and that the Commission accept the LFUCG's recommendation that public fire protection rates be maintained at the rate found equitable, just and reasonable in Case No. 2000-00120 as a means of moving such rates closer to their actual cost of service as determined by Kentucky-American. Further, the LFUCG respectfully requests that the Commission establish a rate for LFUCG-owned public fire hydrants that is equal to fifty seven percent (57%) of the rate charged for company owned hydrants, for the reasons stated herein and its Brief.

²⁴ The forty-three percent (43%) is based upon Kentucky-American's Response to LFUCG First Requests for Information, Question No. 35(d).

Respectfully submitted,

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CERTIFICATION

In accordance with the Commission's procedural orders the undersigned counsel hereby certifies that the original and one copy of the foregoing document have been filed by United States Mail, first class postage prepaid, to Elizabeth O'Donnell, Executive Director, Public Service Commission, 211 Sower Boulevard, P.O. Box 615, Frankfort, Kentucky 40602-0615, and by uploading the document to the file transfer protocol site designated by the Commission. The undersigned counsel hereby certifies that the electronic version is a true and accurate copy of the document(s) filed in paper medium, the electronic version has been transferred to the Commission, and the Commission and other parties have been notified by electronic mail that the electronic version has been transmitted to the Commission. Undersigned counsel also certifies that a copy of the foregoing was served by first class U.S. Mail delivery, postage prepaid, on the following, all on this the ___ day of March 2005:

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