



service.” Additionally, in order for the potential acquisition to be approved, the Commission must find that it “is to be made in accordance with law, for a proper purpose and is consistent with the public interest” pursuant to KRS 278.020(7). The Joint Applicants have the burden of proof to demonstrate these six elements contained in KRS 278.020(6) and (7). See Energy Regulatory Comm’n v. Kentucky Power Co., 605 S.W.2d 46, 50 (Ky. App. 1980) (“Applicants before an administrative agency have the burden of proof.”)

### **III. Discussion**

#### **A. The Joint Applicants have not demonstrated that the proposed acquisition was made in accordance with law.**

In its response to requests for information, ERWA admits that its corporate governing documents required the sale of assets to be approved by its membership. See ERWA Responses to Intervenors’ Second Request for Information, Item 4. It also admitted that the Board of Directors never adopted a resolution recommending the sale of ERWA’s assets to KAWC.

KRS 273.297 identifies mandatory protocol for non-profit corporations when they seek to sell all or substantially all of their assets. First, the corporation’s board of directors must adopt a resolution recommending the sale and directing that the proposed sale be submitted to a vote at a meeting of the members. KRS 273.297(1). Written notice of that meeting must be given pursuant to the provisions of KRS 273.161 to 273.390. Id. At least two-thirds of the members present at the meeting or appearing by proxy must approve the sale. Id.

Simply put, ERWA failed to comply with the requirement for a non-profit corporation that it adopt a resolution recommending the sale of its assets contained in KRS 273.297(1). ERWA admitted that its corporate governing documents required the sale to be approved by its membership and that its board never adopted a resolution recommending that sale. Because

ERWA has failed to comply with this statutory requirement, the proposed acquisition is not being made in accordance with law. The application must, therefore, be denied. See KRS 278.020(7).

**B. The Joint Applicants have not demonstrated that the proposed acquisition is consistent with the public interest.**

In order to approve the transfer, the Commission must also find that the proposed acquisition is consistent with the public interest. KRS 278.020(7). As this Commission has previously noted, the statute does not define the term, “public interest.” The term is justifiably broad and is used in a variety of contexts.<sup>1</sup>

The Joint Applicants may argue “public interest” only involves looking at the acquiring entity based on prior case law. See, e.g., Joint Applicants’ Response to Intervenors’ First Request for Information, Item 3. Although the focus of subsection (6) of KRS 278.020 may be on the acquiring entity to demonstrate its financial, technical and managerial abilities, subsection (7) is broader and clearly requires looking at the entire acquisition. In addition, a close look at Case No. 2002-00018, a case cited by the Joint Applicants, shows that the Commission did not narrowly constrain consideration of what it means to be within the “public interest.” The Commission explained that the parties in that case agreed “that a proposed transfer of control is in the public interest when the proposed transfer produces some benefits for the public and does not adversely affect the utility or the quality of its service.” The Commission essentially agreed stating that “any party seeking approval of a transfer of control must show that the proposed transfer will not adversely affect the existing level of utility service or rates or that any

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<sup>1</sup> For example, a public-interest standard has been used in setting rates (Nat’l-Southwire Aluminum Co. v. Big Rivers Elec. Corp., 785 S.W.2d 503, 517 (Ky. App. 1990), addressing competition in utility markets (In re An Investigation of Nat. Gas Retail Competition Programs, Case No. 2010-00146, 2010 WL 1638238 (Ky. PSC Apr. 19, 2010)), and granting certificates of public convenience and necessity (Kentucky-American Water Co., Case No. 2007-00134, 265 P.U.R.4th 108 (Apr. 25, 2008)).

potentially adverse effects can be avoided through the Commission's imposition of reasonable conditions on the acquiring party." Contrary to the anticipated argument by Joint Applicants in this case, the Commission did not limit a finding of the public interest only on this narrow topic.<sup>2</sup>

In the present context, the public interest demands more than what was provided by ERWA. ERWA failed to ensure that this proposed transfer is consistent with the public interest on two respects. First, ERWA never solicited other acquisition bids or attempted to negotiate with Western Rockcastle. Second, ERWA misled its own customers.

**1. The public interest required ERWA to seek competitive bids for the acquisition or operation of its system.**

ERWA should have publicly announced its intent to sell the system earlier in the process and issued a request for competitive bids for potential purchasers or operators of the system. ERWA began discussions with KAWC no later than March 2017. See, e.g., Joint Applicants' Response to Intervenor's First Request for Information, Item 2 at 124. In fact, it is clear that ERWA and KAWC had detailed discussions on financial accounts at that time. See id. at 124-25. ERWA could have and should have sought other potential purchasers or operators of the system at that time.

The public policy of supporting a sale of assets through a competitive bidding process can be seen in other similar arenas. For example, in discussing the Local Model Procurement Code, the Attorney General has stated that "competitive bidding must be sought so as to foster effective competition. In fostering effective competition, a free and open trade approach is inevitable and ***required in the public interest.***" OAG 81-89 (Feb. 6, 1981) (emphasis added). In

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<sup>2</sup> The public-interest standard was also discussed in Case No. 2002-00317. But in that case, the Commission was specifically dealing with the intervenors' arguments that the Commission should consider the benefits of public ownership of a utility in the context of the potential condemnation of KAWC by LFUCG. The unique circumstances of that case are distinguishable to the present case. Moreover, the potential effects of the ERWA transfer are a direct result of the failure of ERWA to seek competing bids from potential acquirers, as will be discussed herein.

addition, he has stated, “The purpose of requiring bids is to invite competition and guard against favoritism, extravagance, fraud and corruption . . . .” OAG 82-337 (July 6, 1982). Even if it has not adopted the model procurement code, a City would be required to utilize a competitive-bidding procedure for most sales of real and personal property, pursuant to KRS 82.083.

Although ERWA is not subject to these statutory requirements, the policy supporting these statutes supports a finding that ERWA should attempt to obtain competitive bids prior to a sale of its assets. Much like a municipality, the water association is a non-profit corporation. Both entities receive funds from the populations that they serve to provide certain services. ERWA’s funds are public in nature; it acknowledges that it would refund to its membership excess amounts if there were significant funds available after the transaction finalized. See Joint Applicants’ Response to Intervenors’ First Request for Information, Item 16.

ERWA did not issue a request for competitive bidding. See ERWA Responses to Intervenors’ Second Request for Information, Item 8. If it had issued such a request, ERWA could have learned if other parties were interested in acquiring its system. In addition, the potential for competition could have produced a more attractive bid by KAWC either through a higher sales price that would have benefited members or commitments to the system.<sup>3</sup>

The fact that there was a proposed operating agreement with Western Rockcastle Water Association (“WRWA”) does not change this analysis. A publicly released request for bids or request for proposals would have provided better guidance on parameters ERWA sought for potential acquirers or operators. ERWA apparently did not give serious consideration to the proposed operational agreement with WRWA because ERWA wanted a six-month commitment.

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<sup>3</sup> For example, KAWC ignores capital upgrades that are needed for the system and evidenced by the ERWA 2017 Water System Extensions & Improvements, WRIS Project No. WX21203007. In Item 12 of the Joint Applicants’ Response to Intervenors’ First Request for Information, KAWC only mentions replacement of certain meters. KAWC does not acknowledge the need for transmission mains and water lines. If facing competition, KAWC may have submitted a better offer.

See Joint Applicants’ Response to Commission Staff’s Second Request for Information, Item 1(c). A request for bids could have easily described exactly what ERWA desired.

In addition, it is not clear why ERWA refused to negotiate with WRWA.<sup>4</sup> See id. at Item 1(b). It would be reasonable for ERWA to explore all possible solutions, including a mutual aid agreement with WRWA. In fact, there would be several benefits to working with an entity such as WRWA. First, it would keep ERWA’s operations on a more localized level, as opposed to making it a distant outpost of KAWC and accounting for less than half of a percent of KAWC’s nearly 130,000 customers. The Commission has previously emphasized the importance of maintaining utility decisions at a local level. See Kentucky-American Water Co., Case No. 2006-00197, 256 P.U.R.4th 303 (Ky. PSC Apr. 16, 2007)(“that the public interest requires that Kentucky-American's local management have the necessary authority and autonomy to make decisions on a local level”). Second, ERWA would have access to grants and low interest loans that are not available to KAWC. ERWA has a system improvement project currently ranked fourth out of 32 in the Cumberland Valley Area Development District for funding. Thirty percent of the \$905,000 project (or \$271,500) is proposed to be funded by a grant from the Rural Development. This is a grant that will not be available to KAWC if the system is transferred to KAWC.

In order for this acquisition to be within the public interest, ERWA should have issued a request for bids to determine what the best proposal would have been. By issuing such a request, ERWA would have been more likely to receive more bids, potentially from other investor-

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<sup>4</sup> It is particularly strange that ERWA did not attempt to negotiate with WRWA because it appears that the proposed operational agreement was drafted by counsel for ERWA. See Operating Agreement, attached to Joint Applicants’ Response to Commission Staff’s Second Request for Information, Item 1 (indicating that it was prepared on stationary by Jerry Cox); ERWA Board Minutes of Oct. 16, 2017 (indicating that the retainer agreement with Jerry Cox will be terminated). If ERWA wanted a six-month term in the agreement, ERWA should have directed its attorney to include a six-month term in the agreement that was drafted.

owned, non-profit, municipal, or governmentally owned water utilities. This type of free and open “competition” would have guarded against favoritism, extravagance, fraud, and corruption. The public interest required such a process.

Moreover, with a competitive process, ERWA could have provided more information to its membership such that they could provide an informed decision. In contrast, ERWA could only provide one option<sup>5</sup> and even mislead its membership into voting in favor of the transaction.

**2. The public interest required ERWA to provide fair information to its customers without indicating that the takeover was a foregone conclusion or was necessary to avoid a rate increase in the absence of reliable information.**

Every public written communication regarding the transfer suggested that the acquisition was a foregone conclusion, even well before the agreement was finalized. The June 19, 2017, ERWA Board minutes indicate that the “takeover by Kentucky American Water” was discussed. Joint Applicants’ Response to Commission Staff’s First Request for Information, Item 1 at 5.<sup>6</sup> Both the July 7, 2017, posting on Facebook and the July 13, 2017, newspaper advertisement<sup>7</sup> mentioned the “upcoming takeover by Kentucky American Water.” Joint Applicants’ Response to Intervenor’s First Request for Information, Item 1 at 3, 6.

More egregiously, ERWA issued a ballot and made a Facebook posting that indicated that there would have to be a “substantial rate increase” if ERWA did not transfer its assets to KAWC. *Id.* Item 1 at 2, 4. Clearly, when given the choice of two options, customers will chose an option that suggests less out-of-pocket costs. But when pressed with details of a potential rate increase, ERWA is unable to provide detailed information. ERWA had not calculated what a

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<sup>5</sup> The operational agreement with WRWA appears to be an afterthought. ERWA did not consider the operational agreement until the August 21, 2017, board meeting, which was the same date on which the ballots were tallied.

<sup>6</sup> It appears that no one from the public attended that meeting. *See* ERWA Responses to Intervenor’s Second Request for Information, Item 15 at 1.

<sup>7</sup> ERWA provided this notice to the newspaper. *See* ERWA Responses to Intervenor’s Second Request for Information, Item 14.

potential rate increase would be when it made those statements. See id. at Item 12(a). There were no studies, analyses, or calculations to demonstrate that a rate increase was actually needed. See id. ERWA provides in this case financial statements covering a six-month period in an attempt to suggest that a rate increase was necessary, but rate cases are not based on six-month periods. And there is no consideration as to whether ERWA could have reduced expenses or captured more revenue<sup>8</sup> in order to avoid an increase in rates. Obviously, a utility should consider whether it can appropriately reduce expenses rather than threaten to raise rates.

The record of this case indicates that ERWA was not straightforward with its membership. If it indicated that a “substantial rate increase” was necessary, it should have had analysis to support such a statement. Moreover, the public interest demands that ERWA open bids up to all interested parties, such that ERWA can compare all competing offers.

### **C. Other Statutory Standards**

In addition to finding that the acquisition is made consistent with law and within the public interest, KRS 278.020 also requires that KAWC have the financial, technical, and managerial abilities to provide reasonable service and that the acquisition is for a proper purpose. Although it is unclear whether the record of this case fully demonstrates KAWC’s financial, technical, and managerial abilities to provide reasonable service,<sup>9</sup> the Intervenors do not challenge KAWC’s financial, technical, and managerial abilities to provide reasonable service so long as KAWC is committed to providing reasonable service in the local area. Similarly, the Intervenors do not question that the acquisition is for a proper purpose, if it were to meet the other elements of KRS 278.020(7).

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<sup>8</sup> In fact, it appears that capturing more revenue is one of the objectives of KAWC by replacing meters if it acquires the system. See KAWC Responses to Intervenors’ Second Request for Information, Item 5. It is also a component of the WRIS Project No. WX21203007 grant, which is subject to low-interest funding.

<sup>9</sup> In the Application, there is a generic statement that KAWC has financial, technical, and managerial abilities to provide reasonable service, along with reference to KAWC’s annual report. See Application at ¶ 7. Some additional information is provided in response to Item 3 of the Commission Staff’s First Request for Information.



#### IV. Conclusion

The Intervenors simply seek whatever is in the best interests of ERWA's customers. As an initial matter, the best interest of the customers is an open, competitive process whereby ERWA seeks bids from potential acquirers and operators such that ERWA can evaluate each bid fairly. This type of open process will ensure that all potential bidders will have a fair and reasonable opportunity and will enable ERWA to provide reasons to its membership why its recommendation is the best option. This process will also prevent favoritism, extravagance, fraud, and corruption, and is required by the public interest. After such a process, ERWA can appropriately inform its customers as to potential acquirers or operators, providing them with details to make an informed decision that is not biased on statements suggesting inevitable conclusions or unpalatable consequences.

Respectfully submitted

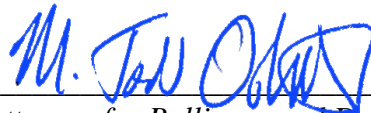


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#### CERTIFICATE OF SERVICE

In accordance with 807 KAR 5:001, Section 8, I certify that the December 29, 2017, electronic filing of this Brief is a true and accurate copy of the same document being filed in paper medium; that the electronic filing will be transmitted to the Commission on December 29, 2017; that there are currently no parties that the Commission has excused from participation by electronic means in this proceeding; and that an original paper medium of the Brief and six copies will be delivered to the Commission within two business days.



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