

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF)
WATER SERVICE CORPORATION)
OF KENTUCKY FOR A GENERAL) CASE NO. 2018-00208
ADJUSTMENT IN EXISTING RATES)

ATTORNEY GENERAL'S POST-HEARING BRIEF

Respectfully submitted,

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Comes now the intervenor, the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention (“Attorney General”), and hereby submits his post-hearing brief in the above-styled matter.

STATEMENT OF THE CASE

Water Service Corporation of Kentucky (“WSCK” or the “Company”) filed its notice of intent to file an application for an adjustment of rates on June 22, 2018 with the Public Service Commission (the “Commission”). WSCK subsequently filed its application on July 5, 2018, utilizing an historic test year ended December 31, 2017. The application requests an increase in revenues totaling \$852,743 per year, or 35.29% over current revenues.¹ The Commission found that the application met the minimum filing requirements and it was deemed filed as of the Commission’s July 19, 2018 order.

The Attorney General was granted intervention on July 30, 2018. The City of Clinton moved for intervention on September 28, 2018, after the deadline for intervention set in the

¹ Application, *Electronic Application of Water Service Corporation of Kentucky for a General Adjustment in Existing Rates*, Case No. 2018-00208 (Ky. Commission July 5, 2018).

procedural schedule,² which prompted WSCK to file a response opposing the intervention request. The Commission ultimately denied the City of Clinton’s motion, finding that the motion did not establish good cause for untimely filing, and that granting intervention at such a late date would serve to unduly complicate the proceedings.³

An evidentiary hearing was originally scheduled for November 7, 2018. On November 5, 2018, WSCK filed a motion to reschedule the hearing due to the unfortunate passing of the supervisor of WSCK operations in Clinton. Upon the filing of a Supplement to the WSCK motion, whereby WSCK agreed not to implement its proposed rates subject to refund before February 12, 2019, the Commission granted the motion, and rescheduled the hearing. On December 19, 2018, an evidentiary hearing was held, and on January 11, 2018, responses to post-hearing data requests were propounded by WSCK.

ARGUMENT

WSCK is a Kentucky corporation whose stock is wholly owned by Utilities, Inc., which is based in Northbrook, Illinois. WSCK provides water service to approximately 6,000 connections in Middlesboro and 600 connections in Clinton, in Bell and Hickman counties, respectively.⁴ In its application for an adjustment of rates, WSCK has proposed an historic test year ending December 31, 2017, based on the 2017 Annual Report. As part of the Settlement Agreement in WSCK’s prior rate case, 2015-00382, WSCK agreed to retain an expert to prepare a cost of service and rate design study to be filed in its next base rate case.⁵

² The deadline for motions to intervene was July 27, 2018, as enumerated in the procedural schedule attached as Appendix A to the Commission’s July 19, 2018 order.

³ Commission Order, Case No. 2018-00208, at 2 (Ky. Commission Oct. 22, 2018).

⁴ Application, Direct Testimony of Michael A. Miller [“Miller Direct”], Jr., Case No. 2018-00208, at 4 (Ky. Commission July 5, 2018).

⁵ Stipulation, Settlement Agreement And Recommendation, *Application Of Water Service Corporation Of Kentucky For A General Adjustment In Existing Rates* , Case No. 2015-00382, at 3 (Ky. Commission May 3, 2016).

I. The Deferred Maintenance Projects Proposed By WSCK Are Not Known And Measurable And Recovery For Those Expenses Should Be Denied

In its application, WSCK initially proposed a total of \$68,823 in pro forma deferred maintenance expenses.⁶ WSCK justified the recovery for these project expenses by claiming that they are known and measurable.⁷ Upon a showing of good cause, pro forma adjustments for known and measurable changes are allowed under 807 KAR 5:001, Section 16(5), in order to ensure fair, just, and reasonable rates based on a historical test period.

In response to post-hearing data requests, WSCK acknowledged that an annual level of amortization to recover inspection costs related to the Clinton–Grubbs Subdivision and ClintonWTP Clearwell tanks is already included in the test year, and accordingly withdrew its request to recover pro forma annual inspection costs in the amount of \$1,240 for that project.⁸ Additionally, at the outset of Mr. Guttormsen’s testimony at the hearing, he provided two corrections to his pre-filed Direct Testimony, one of which adjusted the given amortized test year expense for two tank painting projects downward from \$61,000 to \$51,000.⁹

These tank painting projects in Middlesboro make up the bulk of the deferred maintenance expenses, and consist of reconditioning two 1.25 M gallon ground storage tanks.¹⁰ WSCK based the cost of the tank painting project on cost estimates it received from Dixon Engineering, totaling \$605,000 for both tanks, and which the Company plans to amortize over twelve years.¹¹ During Mr. Miller’s testimony at the hearing, he confirmed that not only had no bids for the project been

⁶ Application, Case No. 2018-00208, w/p [j], Line No. 12 and column F “Pro Forma Deferred Assets” (Ky. Commission July 5, 2018).

⁷ WSCK Responses to Commission Staff’s Third Information Request, Item 11, Case No. 2018-00208 (Ky. Commission September 21, 2018).

⁸ WSCK Response to Staff Post-Hearing Data Request, Item 3, Case No. 2018-00208 (January 11, 2019) (noting that a downward adjustment in the amount of \$1240.00 is necessary to correct the revenue requirement).

⁹ Video Transcript Evidence (“VTE”), Case No. 2018-00208, at 9:01:46–9:02:08 (December 19, 2019).

¹⁰ Application, Direct Testimony of Robert Guttormsen [“Guttormsen Direct”], at 5–6; Application, Direct Testimony of Michael Miller, Jr. [“Miller Direct”], at 8–9; w/p [j], Line No. 12 and column F “Pro Forma Deferred Assets.”

¹¹ Miller Direct at 9; Guttormsen at 5–6.

received, the draft bid specs for the project had not yet been sent out to potential bidders during the fall of 2018 as had been planned.¹² Thus, there is no updated cost estimate to rely on which is the result of a complete bidding process. Mr. Miller further elaborated that WSCK does not have an internal start date set for the project, but that the Company is hoping to start by April.¹³

WSCK also proposed recovery of tank inspection costs for the Bean's Fork Tank, which has never been inspected, and which the Company plans to inspect on a five year cycle.¹⁴ WSCK used its best estimate to determine this expected expense, which it set at \$840.¹⁵ The Company forecasts that this project will begin on March 1, 2019.¹⁶

Nevertheless, for these particular deferred maintenance expenses, WSCK is requesting that the Commission grant its recovery for costs it claims are sufficiently known and measurable, but which in reality are still speculative. Further, the projects are anticipated to start over one year after the end of the test year, but there is no guarantee that they will. The Company even admitted that it is "unaware of any other Kentucky Commission allowed adjustment for a projected capital project which has yet to be started or completed in a historical test-year rate case."¹⁷ The Commission has historically rejected pro forma expenses based solely on an engineering estimate and instead required executed contractor bids to meet the known and measurable standard.¹⁸ In the case of the Middlesboro tank reconditioning projects, the Company has not provided any bids, and

¹² VTE at 9:42:00—9:42:30; WSCK Responses to Commission Staff's Second Information Request, Item 16(i) (Ky. Commission August 28, 2018) (noting that the provided draft bid specs "will go out later this fall to contractors").

¹³ VTE at 9:52:32—9:54:20; WSCK Responses to Commission Staff's Second Information Request, Item 16(h) (Ky. Commission August 28, 2018).

¹⁴ WSCK Response to Staff Post-Hearing Data Request, Item 3(b) (January 11, 2019).

¹⁵ *Id.*

¹⁶ *Id.* at (c).

¹⁷ WSCK Responses to Commission Staff's Third Information Request, Item 11 (Ky. Commission September 21, 2018).

¹⁸ Commission Order, *In the Matter of: Application of Madison County Utility District (A) For Authority To Finance Construction In the Approximate Amount of \$3,000,000; (B) A Certificate of Convenience and Necessity for the Construction of Water Facilities; and (C) Adjustment of Rates*, Case No. 2002-00184, at 10 (Ky. Commission January 27, 2003).

as of the date of the hearing had not taken the first step in the bidding process.¹⁹ As for the Bean’s Fork Tank inspection, the Company relied solely on an internal estimate. The costs and duration for both the Middlesboro tank painting projects and the Bean’s Fork Tank inspection have not been sufficiently established in the record, and work on the projects has not started. Consequently, the Commission should deny any recovery for these expenses, and the associated capitalized time expenses for these particular projects, as they are not yet known and measurable under the standard.

II. The Tax Savings From ADIT And FIT Reductions Stemming From The Tax Cuts And Jobs Act Should Be Returned To WSCK Customers

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 (“TCJA”) became law. Shortly thereafter, multiple Commission cases were initiated to determine whether investor owned utilities should pass back savings from the effects of the tax legislation to customers in the form of rate reductions.²⁰ One of the primary effects of the TCJA was the lowering of the Federal Income Tax (“FIT”) corporate rate from 35% to 21%, which provides an immediate windfall to the Company in terms of lower tax expense. Additionally, excess Accumulated Deferred Income Taxes (“ADIT”) occur as the result of income taxes paid to the utility by customers in anticipation of eventual payment at a certain tax rate, but when the taxes come due to the IRS, they are now due at a lower tax rate than originally planned for. WSCK’s proposal would allow this difference to inure purely to the benefit of its shareholders, and to the detriment of Kentucky families. At the

¹⁹ VTE at 9:42:00—9:42:30.

²⁰ See *Kentucky Industrial Utility Customers, Inc., Complainant; Kentucky Utilities Company, Louisville Gas and Electric Company, Kentucky Power Company, Duke Energy, Inc., Defendants*, Case No. 2017-00477 (Ky. Commission December 21, 2017); *An Investigation Of The Impact Of The Tax Cuts And Jobs Act On The Rates Of Atmos Energy Corporation, Delta Natural Gas Company, Inc., Columbia Gas Of Kentucky, Inc., Kentucky-American Water Company, And Water Service Corporation Of Kentucky*, Case No. 2017-00481 (Ky. Commission December 27, 2017) (Opened upon the Commission’s own motion. The Commission later closed this case and opened separate cases for each of the named utilities, with WSCK being a part of Case No. 2018-00043. Later, that case was incorporated by reference into the present matter, Case No. 2018-00208 in order to address the tax issue holistically within the rate case).

outset, in December 2017, the Commission ordered WSKC to begin recording a deferred regulatory liability on its books.²¹ The Company freely admitted that it did not follow that order, and stated that it still has not begun recording a deferred liability.²²

In the previously separate investigation tax case, WSKC filed testimony from Mr. Lubertozzi putting forth the Company's position on the possibility of a reduction in customer rates due to the TCJA.²³ In that testimony, Mr. Lubertozzi stated that:

WSKC acknowledges that the federal corporate tax rate is decreasing from 35% to 21%, but there are multiple reasons why there should be no rate reduction for WSKC's customers. First, it is too early to determine the full impact of the Tax Act on WSKC or its customers. Secondly, WSKC is not achieving the revenue requirement authorized by this Commission, which was based on a June 30, 2015 test year, and thirdly, assuming the hypothetical revenue determination shown in Table 1 WSKC would only be collecting an additional \$4,281 of annual revenue, which is de minimus [sic].²⁴

In his Post-Hearing data request, Item 4, the Attorney General requested that WSKC provide any legal and/or accounting support it relied on for its current position that its customers are not entitled to any refund due to the effects of the passage of the TCJA. In response, the Company submitted an internal analysis from Utilities Inc., which unilaterally narrowed the scope of its inquiry by self-selecting information focused on only five states, despite Utilities, Inc. operating in 18 states,²⁵ and which only considered regulated operating subsidiaries that "[had their] most recent rate case conclude with either (1) a black box settlement, (2) used an operating margin in lieu of rate base of return, or (3) used a federal corporate income tax rate inconsistent with the 35% federal corporate income tax rate."²⁶ WSKC went on to note that the Illinois Commerce Commission and

²¹ Commission Order, Case No. 2017-00481, at 3 (Ky. Commission December 27, 2017).

²² VTE 10:37:35—10:38:05.

²³ WSKC Testimony of Steven M. Lubertozzi, Case No. 2017-00481.

²⁴ *Id.* at 9.

²⁵ VTE at 10:35:36—10:36:32.

²⁶ WSKC Responses To The Attorney General's Post-Hearing Data Requests, Item 4, Case No. 2018-00208 (January 11, 2019).

the Pennsylvania Utilities Commission recently ruled that Utilities Inc. subsidiaries would not be required to provide refunds to customers due to the TCJA changes since those utilities were not earning at their authorized rate of return.²⁷ Similarly, WSCK noted that the Utilities Inc. New Jersey subsidiary was excluded from the New Jersey Commission’s tax docket due to its size.²⁸ Despite Mr. Lubertozi referencing IRS guidance on the timing of the TCJA,²⁹ the Company did not provide any persuasive or precedential authority, and failed to provide any legitimate support for its position in the form of correspondence with the IRS or a private letter ruling. Instead, as to its position in Kentucky, the analysis relied entirely upon Mr. Lubertozi’s testimony in the prior combined, and now incorporated into this matter, tax case. Even so, the Company’s own deficient analysis still pegged its likelihood of having to refund excess ADIT in Kentucky as “reasonable possible.”³⁰

At the hearing, WSCK also claimed that since the increase from its most recent base rate case, 2015-00382, was obtained through a black box settlement, it has no way of knowing which taxes were included in customers’ rates.³¹ However, multiple other Kentucky utilities which had received their most recent base rate increases through black box settlements agreed to return savings to customers in their own tax investigation cases with the Commission.³² Accordingly, the Attorney General recommends that the Commission employ the same “income statement methodology proposed by Delta Natural Gas Company, Inc., and Columbia Gas of Kentucky, Inc.”

²⁷ *Id.*

²⁸ *Id.*

²⁹ VTE at 10:35:36—10:36:32.

³⁰ WSCK Responses To The Attorney General’s Post-Hearing Data Requests, Item 4, Case No. 2018-00208 (January 11, 2019).

³¹ VTE at 9:09:30—9:15:47; 10:32:00—10:35:08.

³² Commission Order, *Kentucky Industrial Utility Customers, Inc., Complainant; Duke Energy Kentucky, Inc., Defendant*, Case No. 2018-00036, at 10 (Ky. Commission October 31, 2018); *See also* Case No. 2018-00040, *Electronic Investigation of The Impact of the Tax Cuts and Jobs Act on the Rates of Delta Natural Gas Company, Inc.* (Ky. Commission September 21, 2018); Case No. 2018-00041, *Electronic Investigation of The Impact of the Tax Cuts and Jobs Act on the Rates of Columbia Gas of Kentucky, Inc.* (Ky. Commission October 26, 2018).

in their respective TCJA investigation cases, and subsequently ordered in Duke Kentucky's tax case, which "properly passed back to ratepayers the tax reductions without increasing shareholders [sic] actual earned returns and thus [are] in the public interest."³³ The Commission should similarly require WSCK to refund the savings from both the FIT reduction and excess ADIT to its ratepayers. Finally, the Commission should consider admonishing WSCK for failing to follow its direct order to begin recording a deferred liability on its books.

III. The Cost Of Service Study Did Not Take Into Account The Separate Cost to Serve Clinton And Middlesboro

In the instant case WSCK retained and relied upon the expert testimony of Ms. Constance E. Heppenstall for its cost of service study.³⁴ In her engagement with WSCK, Ms. Heppenstall was directed by WSCK to evaluate the Company's cost to serve under consolidated rates for both the Middlesboro and Clinton service areas. It is unclear from the record whether Ms. Heppenstall is aware that the relevant service territories lie just under 400 miles away from each other on opposite ends of the state. Ms. Heppenstall did confirm that she did not consider the separate costs to serve in each territory.³⁵ Considering the drastic difference between the sizes of the customer base in each city, those distinct costs may be quite different, and it would have been beneficial for the Commission to be able to consider those costs separately. Further, without any consideration of the separate cost to serve, the justification for the consolidation of rates between the service territories is essentially that the Company began the process of moving toward consolidation in the last rate case, and wanted to complete the process in this one.³⁶ The Commission should take

³³ Commission Order, *Kentucky Industrial Utility Customers, Inc., Complainant; Duke Energy Kentucky, Inc., Defendant*, Case No. 2018-00036, at 10 (Ky. Commission October 31, 2018).

³⁴ See generally Application, Direct Testimony of Constance E. Heppenstall (Ky. Commission July 5, 2018).

³⁵ VTE at 10:01:50—10:02:10.

³⁶ Application, Lubertozzi Direct Testimony, at 12 (Ky. Commission July 5, 2018); *contra* VTE at 10:00:16—10:01:33 (Where Ms. Heppenstall testified that consolidated rates may improve customer service, relieving confusion among customers who take service from the same utility but pay different rates, and her general belief that customers taking service from same company should pay the same rate.)

this into consideration when making its final determination, especially in terms of gradualism and rate shock for Middlesboro customers.

IV. WSCK Must Find A Solution To the Ambleside Fire Hydrant Situation

The Attorney General has concerns regarding WSCK's apparent inability to collect fees for the Ambleside fire hydrants since 2008, because the total outstanding bill now exceeds \$50,000.³⁷ First, the ensuing socialization of those unrecovered costs to customers who receive no commensurate benefit from those particular fire hydrants is, at its base, inequitable. But the Attorney General is also cognizant of the potential safety consequences and eventual harm for residents of the Ambleside subdivision if the hydrants were to be immediately shut-off and a discontinuation of fire protection enacted. Especially since Mr. Miller testified that he was not aware of whether the homeowner's association or any of the Ambleside residents had been made aware that a shut-off of the hydrants was possible.³⁸

The Company has proposed a surcharge that would only apply to those customers who live in the subdivision, which may recoup the Company's fees for providing the private fire hydrant service, but does not correct the underlying problem of its failure to collect from the original debtor. Going forward, the Company must simply do more to correct this type of inequity without placing any of its customers in potential harm. The Company's response to Staff's request as to why it did not address this issue in its prior rate case is not encouraging:

In WSCK's last rate, [sic] Case No. 2015-00382, WSCK prepared a cost of service study (COSS) internally and in WSCK's current case, Case No. 2018-00208, WSCK had an external consultant prepare the COSS, which brought the Ambleside hydrant issue to the forefront.³⁹

³⁷ WSCK's Responses to Staff's Post-Hearing Data Requests, Item 1 (Ky. Commission January 11, 2019).

³⁸ VTE at 9:49:45—9:50:15.

³⁹ WSCK's Responses to Staff's Post-Hearing Data Requests, Item 1 (Ky. Commission January 11, 2019).

That the Company would not have identified and addressed the issue through an internal cost of service study is troubling on its own from an operational standpoint, but this also gives the Attorney General pause when considering the comprehensiveness and relative merits of WSCK's internal studies, especially in considering its salary analysis in the instant case.

V. The WSCK Internal Salary Study Made Overly Optimistic Assumptions Regarding Wage and Salary Increases

Mr. Andrian Dmitrenko performed, and sponsored through testimony, the competitive salary analysis in the Company's application.⁴⁰ At the hearing, Mr. Dmitrenko confirmed that using a pool of twenty comparable water utilities and their respective annual reports, he took actual data from the years 2012–2016 and extrapolated trends for wage and salary increases in order to forecast 2017–2018 wage and salary levels for those same utilities to then accurately compare to WSCK's projected levels.⁴¹ However, the utilities used in the proxy group, other than WSCK, are entirely water districts, which often do not routinely grant substantial wage and salary increases to the degree that is assumed in these projections. Mr. Dmitrenko acknowledged that he was unaware of water districts' relative inability to increase salaries on a routine basis.⁴² Further, water districts cannot and should not be expected to maintain increases at the same benchmarked level that an investor owned water utility like WSCK may intend to.

The end result of these assumptions is that WSCK's wage and salary level seems closer to the median of the proxy group, and thus more reasonable, than it likely is. The Attorney General recommends that the Commission continue to scrutinize the Company's stated basis for increases and the benchmarks used to justify them, especially in light of the levels of wage increases awarded

⁴⁰ See generally Application, Mr. Dmitrenko Direct Testimony, Exhibits AD-1–AD-4, and Schedules 1–8 (Ky. Commission July 5, 2018).

⁴¹ VTE at 9:29:56—9:30:50.

⁴² VTE at 9:32:15—9:32:25.

by WSCK in 2018: a 3.0% general increase and 3.67% merit increases, which were granted under certain special circumstances.⁴³

CONCLUSION

The Commission has previously acknowledged its long history of relying on the principle of gradualism in rate making in order to mitigate the financial impact of rate increases on customers and Kentucky families.⁴⁴ The Commission should continue to rely on that principle here, especially in the instance of a rate consolidation that affects some residential customers more than others. Furthermore, the Commission should ensure that ratepayers receive the funds that the Company no longer owes in taxes and would otherwise go to further enrich its shareholders.

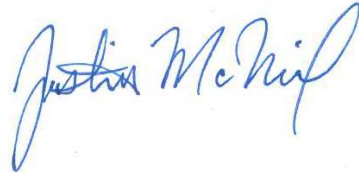
WHEREFORE, the Attorney General requests that the Commission set a fair, just, and reasonable rate for the customers of Water Service Corporation of Kentucky.

⁴³ AG Exhibit 1, WSCK Responses to Commission's Order Dated July 19, 2018, Item 14; VTE at 10:24:00—10:29:39.

⁴⁴ Case No. 2014-00396, *In the Matter of Application of Kentucky Power Company for: (1) A General Adjustment of its Rates for Electric Service; (2) An Order Approving its 2014 Environmental Compliance Plan; (2) An Order Approving its Tariffs and Riders; and (4) An Order Granting All Other Required Approvals and Relief*, Order (Ky. PSC June 22, 2014) (“the Commission has long employed the principle of gradualism”); *See also*, Case No. 2000-080, *In the Matter of: The Application of Louisville Gas & Electric Company to Adjust its Gas Rates and to Increase its Charges for Disconnecting Service, Reconnecting Service and Returned Checks*, Order (Ky. PSC September 27, 2000) (“the Commission is adhering to the rate-making concepts of continuity and gradualism in order to lessen the impact of these increases on the customers that incur these charges.”).

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