

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF)
SOUTHERN WATER AND SEWER)
DISTRICT FOR AN ALTERNATIVE) CASE NO. 2018-00230
RATE ADJUSTMENT)

ATTORNEY GENERAL'S COMMENTS ON STAFF REPORT

Comes now the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention, and pursuant to the Kentucky Public Service Commission (“Commission”)’s July 20, 2018 Order, hereby tenders his Comments in the above-styled matter.

STATEMENT OF THE CASE

Southern Water and Sewer District (the “District” or “SWSD”) is a water utility district organized under KRS Chapter 74, which serves approximately 5,456 customers in Floyd and Knott counties.¹ On July 3, 2018, the District tendered an application with the Commission requesting a revenue increase totaling \$953,409, which would produce \$3,831,896 in total revenues, and would increase the average residential bill, with usage of 4,000 gallons per month, by \$13.20, or approximately 31.88%.²

The District filed its application for rate adjustment pursuant to the Alternative Rate Filing mechanism on July 3, 2018, using a historical test year ending December 31, 2016

¹ *Electronic Application of Southern Water and Sewer District for an Alternative Rate Adjustment*, Case No. 2018-00230 (Ky. PSC July 3, 2018); Southern Water and Sewer District 2016 Annual Report.

² Application, Attachment 1, at 1; Staff Report, *Electronic Application of Southern Water and Sewer District for an Alternative Rate Adjustment*, Case No. 2018-00230, at 2 (Ky. PSC October 24, 2018).

based on its most recently filed Annual Report.³ Following the curing of deficiencies, the Commission accepted the application for filing on July 12, 2018.⁴ The Commission granted intervention to the Attorney General through his Office of Rate Intervention on August 2, 2018.⁵ On September 18, 2018, the City of Pikeville sent a letter to SWSD to inform the utility that it was raising its wholesale water rate for purchased water from \$1.72 to \$2.25 per 1,000 gallons.⁶ On October 24, 2018, the Commission issued its Staff Report.⁷ Shortly thereafter, on October 30, 2018, SWSD submitted a letter accepting the rates recommended in the Staff Report and waiving its right to an evidentiary hearing.⁸

COMMENTS

I. Increase to Revenue Requirement

In its report, Staff calculated that SWSD requires a revenue increase of \$1,110,415 in order to meet the overall revenue requirement, an increase of 37.87%.⁹ The Attorney General does not agree with the level of Staff's recommended increase to the revenue requirement due to affordability concerns in the relevant service territory, the given reasoning for the rate increase—namely a Commission approved transfer of customers—which has now amounted to a poor management decision by the District, as well as other factors including a consistently high water loss rate and failing to ask the Commission to take on debt, all of which will be addressed in these Comments.

³ Application, ARF-Form 1, Sheet 3 of 5.

⁴ PSC Deficiency Cured Letter, Case No. 2018-00230 (Ky. PSC July 12, 2018).

⁵ PSC Order, Case No. 2018-00230 (Ky. PSC August 2, 2018).

⁶ Letter and Notice from the City of Pikeville Regarding Pikeville's Raising of the Wholesale Water Rate at Which They Charge Southern for Water Purchased, Case No. 2018-00230 (Ky. PSC September 18, 2018).

⁷ See Staff Report.

⁸ Letter from SWSD Chairman Accepting KY PSC Staff Report, Case No. 2018-00230 (Ky. PSC October 30, 2018).

⁹ Staff Report at 3, 12.

Notwithstanding the Attorney General’s opposition to the overall amount of the recommended revenue increase, the Attorney General agrees with Staff’s recommendation to allocate any resulting increase evenly across the board. As Staff opined, SWSD did not present any evidence to support its proposed 40.65% increase to the first 2,000 gallons of usage.¹⁰ In the absence of a cost of service study, such an allocation would be unreasonable and punitive for those ratepayers who prudently manage their water use.

In reviewing the District’s filed tariff, Staff was unable to find any contracts for the three wholesale customers who are listed as such in that same tariff.¹¹ Staff thus recommended that the Commission require the District to file those contracts, and applied the same increase to the wholesale rates as were applied to the retail rates.¹² The Attorney General agrees with the recommendation to require the wholesale water contracts in the District’s tariff.

II. Violation of KRS 278.300(1)

Staff acknowledged that the District did not ask for permission from the Commission to obtain two loans from First Guaranty Bank in direct contravention of KRS 278.300(1).¹³ SWSD asked for recovery of the average annual principal interest payments on these loans in addition to the same for two proposed notes issued by the Kentucky Infrastructure Authority (“KIA”), which have not yet been approved by the Commission.¹⁴ The Attorney General agrees with Staff’s decision to recalculate this proposed adjustment, excluding the loans and notes which have not been approved by the Commission as not known and measurable.¹⁵

¹⁰ *Id.* at 3.

¹¹ *Id.* at 4.

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.* at 13–14.

¹⁵ *Id.*

Staff also noted that the Commission may likely open a separate case in order to properly vet and address any statutory or regulatory violations by the District, and hold the Board of Commissions liable if willful violations are found.¹⁶ The Attorney General believes that an investigation into the violation of KRS 278.300(1) is warranted and he would support the initiation of a separate matter to determine the extent of the violations.

III. Water Loss

Staff noted that SWSD reported water loss of 42.85% in its 2016 Annual Report.¹⁷ Although, since SWSD did not provide reports of flushing or fire department use to justify the 60 million gallons claimed for each in the annual report, Staff was forced to reduce both amounts to zero, thereby increasing the presumptive water loss figure to 58.22% for ratemaking purposes.¹⁸ The Attorney General agrees with the Staff's calculation of the utility's water loss in the absence of records to demonstrate such usage.

The Attorney General notes that SWSD's water loss in 2017 remained steady at 42.18%.¹⁹ Similarly, in previous years, water loss was recorded at 42.84% (2015), 39.43% (2014), and 41.05% (2013).²⁰ In describing its reasons for filing its Application, the District refers to the Lackey to Wayland Water Main Replacement project, currently pending with the KIA Drinking Water Loan Fund, as one which will help to reduce its water loss.²¹ The Commission has recently stated that it "is placing greater emphasis on monitoring utilities that

¹⁶ *Id.* at 4.

¹⁷ *Id.* at 9.

¹⁸ *Id.*

¹⁹ 2017 Annual Report.

²⁰ 2015 Annual Report; 2014 Annual Report; 2013 Annual Report (respectively).

²¹ Application, Attachment 2, at 1.

consistently exceed the 15 percent unaccounted-for water loss threshold.”²² Furthermore, the Commission has recently required more stringent water loss reporting and suggested that failure to demonstrate progress in reducing water loss may engender additional scrutiny.²³ The Attorney General submits that the District should similarly be required to demonstrate incremental progress with its own efforts to reduce water loss moving forward.

IV. Customer Transfer to Prestonsburg City Utilities Corporation

In its Application, the District cited the main reason for requesting the increase as an operating deficit caused by the recent transfer of some 1,200 customers to Prestonsburg City Utilities Commission (“PCUC”), which has ostensibly led to SWSD’s “financial condition . . . deteriorat[ing] considerably.”²⁴ SWSD later stated that it

did not have the personnel or equipment to operate the wastewater treatment plant and system in the Harold area in addition to two other wastewater plants. In order for Prestonsburg to assume ownership of the wastewater system they took the water customers also. The loss of the 1,160 customers has severely harmed the District’s financial situation.²⁵

SWSD’s description of the arrangement was later disputed through a letter filed into the record of this matter by PCUC’s Superintendent/CEO, Turner Campbell.²⁶ In addition to providing a historical narrative of SWSD’s wastewater services and its relationship with PCUC, Mr. Campbell emphasized that the transfer of customers was not a hostile takeover by PCUC.²⁷

²² Final Order, *Electronic Application of Martin County Water District for an Alternative Rate Adjustment*, Case No. 2018-00017, at 13 (Ky. PSC November 5, 2018); see also Final Order, *Application of Ledbetter Water District for an Alternative Rate Adjustment*, Case No. 2018-00117, at 3 (Ky. PSC September 10, 2018); Final Order, *Electronic Application of West Carroll Water District for Rate Adjustment*, Case No. 2017-00244, at 2 (Ky. PSC April 24, 2018).

²³ Final Order, Case No. 2017-00244, at 2.

²⁴ Application at 1.

²⁵ *Id.* at 10.

²⁶ *Prestonsburg City Utilities Commission Clarification of Southern Water District Reasons for Application*, Case No. 2018-00230 (Ky. PSC July 16, 2018).

²⁷ *Id.* at 1.

Rather than simply losing water customers, SWSD knowingly transferred those water customers in order to fully satisfy the terms of the deal with PCUC to also transfer the operation of wastewater services; services SWSD was no longer able to adequately perform.²⁸ In fact, in their joint application seeking approval of the transfer, the parties represented that the transaction was at arm's length and that both utilities were "knowledgeable and willing parties of equal negotiating strength."²⁹ For the District to now suggest that it did not undertake that transaction with a clear understanding of the possible consequences is troubling.

Moreover, when the transfer of these customers was first proposed and considered by the Commission, SWSD should have sought to determine whether a merger with PCUC would have been the better course of action for the utility and its customers. More so, since the application in that matter emphasized that "[t]he public policy of the Commonwealth ... is to encourage regionalization, consolidation, and merger of water and wastewater utilities whenever feasible," and stated that the mooted transfer was in the furtherance of this policy.³⁰ At the very least, had the District performed some analysis on the costs and benefits of a full merger for the Commission's consideration, it may have demonstrated whether the current dire circumstances could have been foreseen less than two years ago when this transfer was first proposed. The Attorney General is concerned that the District has now based the requested rate increase on the results stemming from this approved transfer, especially since

²⁸ Application, Attachment 2, at 1.

²⁹ Joint Applicants' Response to First PSC Information Request, *Electronic Joint Application of Southern Water and Sewer District; Prestonsburg City's Utility Commission; and the City of Prestonsburg for an Order Approving the Transfer of Ownership of the Wastewater System and Certain Portions of the Water System of Southern Water and Sewer District*, Case No. 2017-00044, 1-1 at 1 (Ky. PSC March 13, 2017).

³⁰ Joint Application for Approval to Transfer Wastewater Assets and Certain Water Assets, Case No. 2017-00044, at 9 (February 6, 2017) (referencing KRS 224A.300(1), KRS 74.361(1)).

the District recently received rate increases in 2009, 2012, and 2015.³¹ If the transfer of these customers has been as financially devastating as SWSD claims, then the Commission may need to seriously consider a merger scenario.

V. Affordability in Service Territory

The Attorney General wishes to reiterate that the counties which comprise the service territory of the District are among the poorest in Kentucky, with 2010 poverty rates for Floyd and Knott counties listed as 28.1% and 24.1% respectively.³² In determining whether the rates requested are fair, just, and reasonable, the Commission should also look to the affordability of the proposal in relation to the ratepayers who are being asked to pay for such an increase.

Finally, the Attorney General does not necessarily agree with Staff's recommendation regarding any issue present in the Staff Report that he did not address in the preceding Comments.

CONCLUSION

The Commission has often acknowledged its long history of reliance on the principle of gradualism in ratemaking in order to mitigate the financial impact of individual rate increases on customers.³³ The Attorney General asks that the Commission continue to follow that precedent here. In the case at bar, the District seeks a revenue increase of 33.12%, despite

³¹ See *Application of Southern Water and Sewer District for an Adjustment in Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities*, Case No. 2012-00309 (Ky. PSC August 8, 2012); Case No. 2015-00192, Case No. 2009-00398 (The 2015 and 2009 rate increases were granted in CPCN applications made pursuant to KRS 278.023 which requires the Commission to accept agreements between the water utility and the U.S. Department of Agriculture or the U.S. Department of Housing and Urban Development).

³² Historical County Level Poverty Estimates Tool, United States Census Bureau, accessible at: <https://www.census.gov/library/visualizations/time-series/demo/census-poverty-tool.html>.

³³ 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.”).

three rate increases in the past ten years. In its application for this increase, it claims that the transfer of customers to another utility which it willingly sought and agreed to has precipitated the magnitude of this request. Meanwhile, the District has reported water loss figures near 40% for the past three years,³⁴ and did not provide justification in the current record for flushing and fire department usage, leading the Staff to impute an even higher water loss percentage for 2016. Even so, Staff calculated that the District requires a 37.87% increase to its revenue, significantly higher than the amount originally requested, and SWSD has readily accepted the Staff's recommendation.³⁵ Further, the District failed to include wholesale water contracts in its tariff and failed to ask for Commission approval to take out long term loans.

As the Commission made clear in the final order it issued in Martin County Water District's alternative rate filing, it will not condone consistently bad management decisions by granting a rate increase without instituting a commensurate level of heightened scrutiny toward that utility.³⁶ The Attorney General realizes that SWSD is not in the same position as Martin County Water District. Nonetheless, the point still stands that the Commission should refrain from simply granting the District the entirety of the recommended increase due to the District's own poor management decisions. The Commission should further impose reporting requirements for water loss, open an investigative case into the loans taken out without Commission approval, require SWSD to file its wholesale water contracts in its tariff, and require SWSD to perform a feasibility and cost-benefit analysis on merging with PCUC.

³⁴ 2017 Annual Report at 56; 2016 Annual Report at 56; 2015 Annual Report at 61.

³⁵ SWSD Acceptance Letter.

³⁶ See Final Order, Case No. 2018-00017.

WHEREFORE, the Attorney General defers to the Commission, based upon the evidentiary record, to set a fair, just, and reasonable rate for the customers of Southern Water and Sewer District. The Attorney General does not believe a hearing is necessary in this case, and requests that it be submitted upon the record.

Respectfully submitted,

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