

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)

SOUTHERN WATER AND SEWER DISTRICT’S POST-HEARING BRIEF

Comes the Southern Water and Sewer District (“Southern”), by and through counsel, and for its Post-Hearing Brief, submits as follows.

I. STATEMENT OF THE CASE

A. ASSET TRANSFER BETWEEN SOUTHERN AND THE CITY OF PRESTONSBURG/PCUC; CASE NO. 2017-000444

Substantial time and resources have been dedicated to revisiting Commission Case No. 2017-00044, which approved the transfer of portions of Southern’s wastewater and water assets and customers to the City of Prestonsburg and Prestonsburg City’s Utilities Commission (“PCUC”). As stated in Southern’s opening remarks at the January 8, 2019, hearing, that transfer was approved by the Commission and no person or entity intervened, including the Attorney General. As stated throughout this Brief, in other documents filed by Southern in this case and Case No. 2017-00044, and in the testimony of Southern’s Commissioners, Dean Hall, and Turner Campbell, Southern’s Commissioners made the best decision it could at the time of the agreement of the asset transfer. Southern, the PCUC, and the City of Prestonsburg determined that it was also in their best interests to move forward with the transfer of assets.

This purchase of assets was not a wholly altruistic act by the PCUC and Prestonsburg. The PCUC was acquiring a new, well-functioning wastewater treatment plant with plenty of

capacity. Prestonsburg itself was struggling at the time with the decision of expanding the Prestonsburg Wastewater Treatment Plant. By purchasing Southern's wastewater infrastructure, especially the Harold Wastewater Treatment Plant, Prestonsburg avoided the costs of having to expand their existing plant, allowing Prestonsburg to extend sewer infrastructure to new customers on the U.S 23 corridor. *See* Resolution adopted by the PCUC to approve the Asset Purchase Agreement:

WHEREAS, if PCUC acquires the Harold WWTP, it can reverse the of wastewater, divert a substantial portion of the wastewater from its existing wastewater treatment plant to the Harold WWTP, and create additional capacity at the PCUC WWTP;

WHEREAS, acquisition of the Harold WWTP will enable PCUC to forego substantial capital improvements at the PCUC WWTP;

WHEREAS, acquisition of the Harold WWTP will enable PCUC to more economically extend wastewater service along the US 23 Corridor to the Floyd/Pike County Line.

Asset Purchase Agreement Between Southern Water and Sewer District and City of Prestonsburg, January 1, 2017 ("Asset Purchase Agreement"), Exhibit 5 at page 2; filed in Case No. 2018-00230 on 1/7/2019. *See also* Resolution adopted by the City of Prestonsburg to approve of the Asset Purchase Agreement:

WHEREAS, the City's existing wastewater treatment plant (the "City WWTP") is currently operating at maximum capacity;

WHEREAS Southern District's Harold/Betsy Layne Wastewater Treatment Plant (the "Harold WWTP") is modern, operates approximately 50% of its rated capacity of 100,000 gallons per day, is expandable to 400,000 gallons per day, and is strategically located along the U.S. Highway 23 corridor (the "US 23 corridor");

WHEREAS, if the City acquires the Harold WWTP, PCUC can reverse the flow of wastewater, divert a substantial portion of the wastewater from its existing wastewater treatment plant to the Harold WWTP, and create additional capacity at the City WWTP;

WHEREAS, acquisition of the Harold WWTP will enable the city to forego substantial capital improvements at the City WWTP;

WHEREAS, acquisition of the Harold WWTP will enable the City and PCUC to more economically extend wastewater service along the US 23 Corridor to the Floyd/Pike County Line;

Id., Exhibit 6 at page 2. While PCUC was taking on other older sewer infrastructure and customers from Southern, and all parties involved agreed that Southern should transfer those customers and assets, Prestonsburg and PCUC also did receive substantial benefits from the transaction.

Still, because of Southern's precarious position with their wastewater assets, the likelihood of substantial fines from the Kentucky Division of Water, and Southern's inability to locate and retain a reliable and certified wastewater operator, Southern agreed to offload its wastewater infrastructure and customers along with some of the more reliable sections of its water system. The contractors and consultants Southern were able to hire performed poorly and were terminated. As the wastewater treatment facilities continued to generate notices of violation and potential substantial fines and fall into disrepair, Southern made a calculated decision to turn over the wastewater treatment facilities and assets to PCUC, which was well qualified to operate and maintain those facilities. However, PCUC would not accept the wastewater infrastructure without the transfer of certain water customers to PCUC. Faced with the Sophie's choice of continued wastewater failures and fines or the loss of revenue from water customers, Southern agreed to the water customer and asset transfer. After the asset transfer was finalized, Southern quickly realized that the loss of water customers would significantly impact its monthly revenue stream. Hence, Southern filed for a rate adjustment with the Commission. Certainly, other factors have significantly affected Southern's revenue stream over the past five to ten years, including the decline in availability of coal severance dollars, the continuing movement of people out of Appalachia, and economic stagnation in the region. In concert with the loss of customers, Southern cannot properly manage its existing water assets without a rate increase.

In addition, permeating throughout the 2017 transaction was the Floyd County Fiscal Court's insistence through some alleged "hand shake" agreement that it was entitled to an additional 1.8 million dollars that the Commission and the Attorney General both agreed was not owed to the Fiscal Court. *See* Commission Order dated July 12, 2013, Case No. 2012-00309, and Attorney General Comments dated March 19, 2013, Case No. 2012-00309. As indicated by the testimony of Turner Campbell *infra*, the PCUC has allocated approximately 1.8 million dollars to Southern pending resolution of disputes between Southern, the PCUC, and the USDA RD.

Regardless, Southern has essentially transferred the 1,160 customers to the PCUC, pending USDA RD's release of certain liens it holds. On the other hand, Southern has also offloaded its troubled sewer infrastructure it was struggling for years to maintain and operate. Southern is now in need of a rate increase, and the Commission Staff agrees. *See* Staff Report dated 10/24/18.

B. SOUTHERN'S RATE APPLICATION; CASE NO. 2018-00230

1. Rate Application and Intervention

On June 26, 2018, Southern filed a Notice with the Kentucky Public Service Commission ("Commission") in conformity with 807 KAR 5:001, Section 8, expressing its intention to file an application for a rate adjustment with the Commission no later than July 6, 2018 pursuant to the Commission's Alternative Rate Filing procedures, 807 KAR 5:076. Southern also requested Commission approval for use of electronic filing procedures in the proceeding. On July 2, 2018, Commission staff sent a letter to Southern acknowledging receipt of notice of election of use of electronic filing procedures to file an application and assigned the application Case No. 2018-00230. The letter also established procedures for electronic submission pursuant to 807 KAR 5:001.

On July 3, 2018, Southern filed its Alternative Rate Filing with the Commission. Southern used its Annual Report for the twelve months ending on December 31, 2016, as required by 807 KAR 5:076, along with known measurable changes to test-year operations, as the test period to determine the reasonableness of its proposed rates. Southern sought the Commission's approval of an increase in its annual revenues of \$953,409 and total revenues from service rates of \$3,831.896, an increase of 33.12%. Southern proposed to allocate the rate increase among its retail customers. The primary reason for the rate increase stated by Southern was the transfer of 1,160 water customers to the Prestonsburg City's Utilities Commission (PCUC) as described above. In the application, Southern also explained it had two major infrastructure projects pending with the Kentucky Infrastructure Authority's Drinking Water Loan Fund critical to the District's operation that were also dependent on the requested rate increase. At the time of the filing, Southern had 5,435 customers remaining. With its Application, Southern presented supporting documentation provided by Holly Nicholas of Kentucky Engineering Group, PLLC.

On July 9, 2018, the Commission sent a Filing Deficiency letter to Southern, stating Southern failed to provide a detailed analysis of its customers' bills showing revenues from present and proposed rates from each customer class. That deficiency was corrected, and on July 12, 2018, the Commission staff determined the Application met the minimum filing requirements and docketed the case.

Turner Campbell, on behalf of the PCUC, then submitted a letter to "take exception to certain wording utilized in [Southern's] filing." 7/12/2018 Letter at 1. Mr. Campbell alleged the wording on the application "infers somewhat of a 'hostile' takeover of water customers by Prestonsburg." *Id.* Mr. Campbell stated the inference "could not be further from the facts involved." Mr. Campbell also enclosed with the letter a "Brief History of Southern and

Wastewater Collection/Treatment Services” outlining the history of the transaction from his perspective.

By Order dated July 20, 2018, the Commission established a Procedural Schedule providing for the deadlines and standards for intervention, required the Commission Staff to file a written report containing its findings and recommendations regarding the requested rate increase, and required any objections or comments to the Staff Report submitted within 14 days of the filing of the Staff Report. The Commission also required that any request for a hearing or informal conference be done in the response to the Staff Report.

On July 25, 2018, the Attorney General moved to intervene. The Commission granted full intervention to the Attorney General on August 2, 2018.

2. Staff Report

The Commission filed its Staff Report on October 24, 2018. To determine the reasonableness of the rates requested by Southern and whether operations reported for the test year were representative of normal operations, the Commission Staff performed a financial review of Southern’s test-year operations. The Commission found that Southern’s Overall Revenue Requirement is \$4,201,262, and that a \$1,110,415 revenue increase, or 37.87%, to pro forma rate revenues is necessary to generate the Overall Revenue Requirement.

Instead of increasing the retail rate with different percentage increases, the Commission, based on Commission precedent, suggested that allocation of a revenue increase should be applied evenly across the board to Southern’s rate design. *Id.* Following that precedent, the Commission recalculated Southern’s rate and rates schedule to apply evenly across the board. Commission Staff reviewed Southern’s tariff and noted that it did not possess contracts for Southern’s wholesale customers.¹ Commission Staff also proposed an increase in Southern’s

¹ That information was provided in a subsequent Commission Data Request.

wholesale customers' rates in the same manner that the retail water service rates were proposed to be increased.

The Commission Staff also took issue with two outstanding loans with First Guarantee Bank for which Southern failed to obtain Commission approval as required by KRS 278.300. The Commission Staff stated Southern should be aware that the Commission may initiate a separate proceeding to more thoroughly investigate the possible violations of Commission statutes and regulations, and that members of Southern's Board of Commissioners may be subject to civil and criminal liability.²

Southern's Pro Forma Operating Statement for the test year ended December 31, 2016 was also analyzed by Commission Staff. The Commission Staff found Southern's adjustments for lost revenues of \$656,122 and loss of 60,744,000 gallons previously sold to the transferred 1,160 customers are reasonable and should be accepted by the Commission. Commission Staff reviewed Southern billing analysis and the adjustments provided in the Application and found that Southern's retail water sales revenues of \$2,889,953 and their wholesale water sales revenues of \$42,393, as determined by the adjusted billing analysis, were accurate representations of normalized test-year revenue from water sales.

The Commission Staff made changes to the accounting for Tap Fees, capitalizing the amount associated with setting water taps at \$450.00 over 40 years. The Commission Staff also reduced Southern's purchase water calculations by \$162,422 to account for the lost 1160 customers, and increased its purchased water expense by \$67,835 to account for an increase in wholesale rates.

² Southern's Commissioners addressed these allegations through testimony at the January 8, 2018 hearing.

Commission Staff also made adjustments to Southern's calculated water loss. Like many water districts in Eastern Kentucky, Southern is experiencing significant water loss in its system. While Southern is taking the necessary steps to address and control its water loss, much work remains. The Commission Staff noted that Southern was unable to provide sufficient flushing records or records of fire department use at the time of Staff's review. Thus, Commission Staff reduced the amounts reported for system flushing and fire department use to zero gallons. However, Southern has since demonstrated to the Commission that it uses a reasonable alternative to calculating water loss due to flushing and fire department use.³ Still, the Commission Staff calculated Southern's water loss to be 58.22 percent, instead of the 42.85 percent reported by Southern. The Commission staff calculated the cost to purchase, pump, and treat excess water loss based on its 58.22 percent water loss calculation to be \$385,603.

Commission Staff also has removed from pro forma expenses the \$10,855 of depreciation recorded in the test year for the water assets that have yet to be formally transferred to PCUC. Commission Staff found that although Southern has yet to transfer the assets to PCUC, there is an Operating and Maintenance Agreement between Southern and PCUC making PCUC principally responsible for maintaining the portion of Southern's system that is to be transferred to PCUC and allowing PCUC to collect the water service revenues for the customers' meters that are being maintained by PCUC. Commission Staff also removed the payments made for Sales Tax and the payment Southern received from PCUC as an advance on the pending transfer of the water and wastewater assets to PCUC in the amount of \$115,000 from test year operations.

³ Through testimony of Dean Hall at the January 8, 2019, hearing, and through Responses to the Commission's Data Requests, Southern has since explained and verified, through the assistance of the Kentucky Rural Water Association (KRWA), that it now calculates its flushing and fire department use through formulas and methodologies provided by KRWA. Using those formulas and methodologies, Southern has calculated water loss due to flushing at 12,000,000 gallons, and water loss due to fire department use at 9,429,513 for the 2016 test year. *See Exhibit 1.*

Commission Staff also determined that Southern used the proceeds from the First Guaranty loan to pay for current operating expenses. In doing so, Commission Staff found that Southern failed to adhere to the procedures of KRS 278.300(1). Thus, Commission Staff found Southern should not be allowed rate recovery of the associated debt service. Commission Staff also found that two proposed notes payable to KIA that are in the process of being approved, but not final, should also not be allowed rate recovery at this time. Commission Staff re-calculated Southern’s annual debt service to be \$447,499. Commission Staff re-calculated Southern’s allowance for additional working capital to be \$89,500.

The Commission Staff calculated proposed Monthly Water Rates to be:

Staff Calculated Monthly Rates			
First	2000 gallons	\$33.92	Minimum Bill
Over	2000 gallons	\$11.58	per 1,000 gallons
Wholesale Customers			
City Hindman		\$3.78	per 1,000 gallons
Knott County Water District		\$3.86	per 1,000 gallons
City of Wheelwright		\$3.75	per 1,000 gallons

On October 26, 2018, Southern filed with the Commission a letter accepting the Staff Report with no objections, waiving Southern’s right to a hearing and accepting the rates developed by the Commission Staff.

3. Attorney General’s Comments on Staff Report

The Attorney General filed his Comments to the Staff Report on November 11, 2018. The Attorney General objected to the Commission Staff’s proposed 37.87% revenue increase. The Attorney General alleges the rate increase was due to a “poor management decision” by Southern to transfer a portion of its water assets and customers to PCUC, water loss, and failing to ask the Commission to take on debt. Although he failed to intervene in the asset transfer case, the Attorney General questioned Southern’s asset transfer to the PCUC and claims the Commission and Southern should have considered the merger of PCUC and Southern. The

Attorney General agreed with the Commission Staff and suggested an investigation into the violation of KRS 278.300(1) is warranted. The Attorney General also suggested Southern should demonstrate incremental progress to address water loss and suggested the Commission take into consideration the affordability of rates.

4. Commission Order Requesting Hearing

By Order dated November 15, 2018, the Commission requested a hearing on December 18, 2018, be held to investigate issues related to water loss, the unauthorized debt noted by Commission Staff, and other issues. The Commission required the appearance of Southern's General Manager, Dean Hall, and Southern's Commissioners, Paula Johnson, chairman; Larry Joe Osborne, treasurer; Barry Hall, secretary; Joe Jacobs, board member; and Hayes Hamilton, board member. Southern was required to file witness and exhibit lists with the Commission and give notice of the hearing pursuant to 807 KAR 5:00, Section 9(2)(b). The Commission also subpoenaed Les Stapleton, Mayor of Prestonsburg, and Tuner Campbell, Manager of PCUC. The Commission also sent two Requests for Information to Southern.

After receiving the November 15, 2018 Order and Requests for Information, Southern retained the undersigned law firms as counsel. Southern duly complied and responded to the Requests for Information and submitted its Witness and Exhibit List. Southern's witnesses included each of Southern's Commissioners, Dean Hall, Holly Nicholas, and Tim Blanton of KRWA. Southern requested Danny Stinson of KRWA to appear, but he was unavailable that day. Southern also listed as exhibits all documents in response to the PSC's data requests and Southern's Water Loss Management Plan. The undersigned entered their appearance as counsel for Southern on December 14, 2018.

On December 16, 2018, Southern unexpectedly had to move to reschedule the December 18, 2018 hearing.⁴ The Commission granted that motion, noting that Southern agreed it will not implement its proposed rates subject to refund earlier than February 1, 2019, as otherwise permitted by KRS 278.190. The hearing was rescheduled for January 8, 2019. The Commission once again subpoenaed Les Stapleton and Turner Campbell to appear at the hearing. The Commission also subpoenaed Terry Fyffe, who prepared the appraisal of the water assets transferred from Southern to the PCUC. The Commission sent its Third Request for Information to Southern on January 3, 2019. Southern timely responded to the Third Request on January 7, 2019. The Commission subsequently excused Mr. Fyffe from appearing at the hearing due to his unavailability on short notice.

5. January 8, 2019 Hearing

Southern, along with its General Manager, Dean Hall, and Southern's Commissioners, Paula Johnson, Larry Joe Osborne, Barry Hall, Joe Jacobs, and Hayes Hamilton appeared at the hearing. Also attending were Holly Nichols of Kentucky Engineering and Danny Stinson and Tim Blanton of KRWA. Terry Campbell and Mayor Les Stapleton also appeared at the hearing pursuant to the subpoenas.

a. Testimony Summary of Turner Campbell

Turner Campbell, the Superintendent/CEO of the PCUC, was called to testify first by the Commission. Mr. Campbell testified about the history of the asset purchase agreement between Southern and the PCUC. Mr. Campbell revealed that he believed Floyd County owns at least some assets currently being used by Southern. Mr. Campbell testified that he believed the total fair market value of the assets purchased by the PCUC from Southern, both wastewater and water, is likely \$4.1 million to \$4.3 million. Mr. Campbell testified PCUC has made

⁴ The undersigned Randal Strobo's father passed unexpectedly on December 14, 2018.

improvements to both the wastewater assets and the water assets. Video Recording of the January 8, 2018 hearing (“V.R.”) at 9:49:25.⁵ Regarding wastewater assets, Mr. Campbell testified that Southern was having difficulty making needed improvements, and they needed additional resources and staff. *Id.* at 9:53:36.⁶ Mr. Campbell agreed that both Southern and the PCUC improved their respective situations because of the asset transfers. *Id.* at 10:36:42.

In addressing the Commission’s and the Attorney General’s questions regarding merger, Mr. Campbell stated PCUC is not interested in purchasing Southern outright, and that it would stretch their resources too thin. *Id.* at 10:10:30. Mr. Campbell also revealed that PCUC is not currently collecting revenue from the wastewater customers transferred to PCUC (about \$8,000.00 a month) because of Southern’s financial situation -- but, it would expect to start collecting once a rate increase was put in place. *Id.* 10:50:02. Mr. Campbell also testified that PCUC did not sign a conflict waiver when the PCUC, the City of Prestonsburg, and Southern were all represented by the same counsel, nor was he aware of anyone ever recommending to Southern to retain its own counsel for the asset purchase negotiations and application. Mr. Campbell also testified that Prestonsburg has set aside approximately \$1.8 million to compensate Southern, but that they are negotiating with the USDA RD on a final settlement number.

b. Testimony Summary of Les Stapleton, Mayor of Prestonsburg

Les Stapleton was called next by the Commission. Mayor Stapleton stated that had the appraisal on the water assets been done two years ago, Prestonsburg likely would not have

⁵ Available at https://psc.ky.gov/PSC_WebNet/Video.aspx.

⁶ In Mr. Campbell’s “Brief History of Southern and Wastewater Collection/Treatment Services” filed with the Commission on July 16, 2018, Mr. Campbell also states, “Through no true fault of Southern's management the providing of wastewater collection and treatment services became somewhat of a nightmare for the District culminating in Kentucky Division of Water enforcement actions commencing in late 2015/early 2016. It had become the general consensus by that time that although the Fiscal Court had very good intentions, their attempt to involve the Southern Water District in the providing of wastewater collection and treatment was simply not working.”

agreed to the transaction. *Id.* at 11:00:02. He also testified that Prestonsburg has access to good water, which is unique in the region. *Id.* at 11:04:47.

c. Testimony Summary of Paula Johnson, Southern Board Chair

Next, the Commission called Paula Johnson, Chair of Southern's Board of Commissioners. Chair Johnson has been a member of Southern's board since 1995. She was questioned extensively about the terms and term limits of Board members, and overall governance of the Board. Chair Johnson testified that Southern had adopted an Ethics Policy. *Id.* at 11:29:15.

Chair Johnson was questioned on the operation of Southern and water loss. She testified Southern has and continues to do work to address water loss, such as replacement of main distribution lines that have resulted in sizeable improvements. *Id.* at 11:31:08. Chair Johnson stated that Southern employs a leak detection team – a three member crew work five days a week to address leaks and that leak detection is difficult because of Southern's geographic obstacles. *Id.* at 11:32:40. She testified leak loss is 60% now, but water line loss is also more-accurately measured now. She believes that leak detection has improved drastically, and that Southern continues to work with leak detection experts such as the KRWA. *Id.* at 11:37:07. Southern has also considered purchasing smart meters, but financial considerations have precluded such purchase at present. *Id.* at 1:26:20. Chair Johnson stated that Southern prosecutes individuals for water theft through the county attorney's office. *Id.* at 11:40:10. She testified that water loss is a problem and Southern takes it seriously. *Id.* at 1:20:10. Chair Johnson also testified that Southern's biggest issue currently is lack of financial resources. *Id.* at 11:38:49.

Chair Johnson was questioned by the Commissioners regarding the failure to seek approval for indebtedness that exceeded two years. Chair Johnson stated that it was an oversight, and that Southern did not intentionally avoid the Commission, intentionally skirt the rules, and

that she has never done anything intentionally illegal or immoral. She testified that she spent her career in law enforcement. *Id.* at 11:59:25. She testified that all Commissioners comply with training requirements and keep certificates on file at Southern's office. *Id.* at 11:44:35. Chair Johnson emphasized that Southern may have financial issues, but it is able to provide clean, safe water to its customers. *Id.* at 1:45:10.

Regarding the transfer of assets, Chair Johnson stated that no analysis was conducted to determine the impact loss of customers, and that Southern was relying on the advice of the PCUC and the Floyd County Fiscal Court. Chair Johnson claimed that the PCUC and the Fiscal Court were pushing Southern to complete the asset transfer deal. *Id.* at 11:53:50.

d. Testimony Summary of Commissioner Joe Jacobs

Next, the Commission called Joe Jacobs. Mr. Jacobs was questioned regarding his term, as Mr. Jacobs had just learned that his term had expired. *Id.* at 2:11:50. He testified that there was political pressure to complete the asset transfer deal with the PCUC. *Id.* at 2:17:30. He also emphasized that Southern always kept the demographics of their customers in mind, and never wanted to implement rates that the average customer could not afford. *Id.* at 2:24:55. He testified that the requested rate increase is needed to replace lines and to prevent water loss. He stated that Southern was a good board and was well run. *Id.* at 2:26:05. Regarding governance, Mr. Jacobs testified that Minutes of each meeting are kept and approved and reports are prepared for the Commissioners to review. *Id.* at 2:20:35. He agreed that Southern could provide to the Commission copies of all meeting minutes. *Id.* at 2:30:30.⁷

e. Testimony Summary of Dean Hall, Southern General Manager

⁷ Southern has provided all Southern Board Meeting Minutes from January 2013 to present in response to the Commission's Third Request for Information.

The Commission then called Dean Hall, General Manager of Southern. Mr. Hall has been the General Manger for Southern since 2014.

Mr. Hall was questioned about water loss by the Commission. Mr. Hall testified that when he became general manager in 2014, he was aware of Southern's water loss and that the placement of water lines in difficult terrain contributes to high water loss. *Id.* at 2:36:50. Southern has a leak detection crew on staff that works eight hours a day, five days a week to find and identify leaks. *Id.* at 2:53:50 Southern pays this crew overtime regularly. *Id.* Southern works closely with the Kentucky Rural Water Association, specifically Danny Stinson, on leak detection and overall operation of Southern. *Id.* at 3:45:20. Mr. Stinson worked with Southern officials to prepare the leak detection operating procedures currently employed by Southern. *Id.* at 3:46:25. Southern has observed substantial reductions in water loss since the policy has been put in place, and Southern now measures leaks more accurately and efficiently. *Id.* at 3:47:40, 3:48:20. Mr. Hall testified that Southern could reasonably attain 30% water loss in five years. *Id.* at 3:50:30.

The Commissioners questioned Mr. Hall regarding complaints of failure to read meters, and the failure to test and replace meters. Mr. Hall stated Southern's crew of three meter readers aims to read 200 meters per day. *Id.* at 2:46:55. If he discovers his employees are not reading the meters, Mr. Hall will terminate them. *Id.* If a meter is not read because of delay such as traffic, the bill sent to the customer denotes that the bill is estimated. *Id.* at 2:48:30.

Mr. Hall has told the Board that Southern is not in complete compliance with meter testing and replacement and needed to improve. *Id.* at 2:42:40. Mr. Hall stated he would like to have new smart meters and has also made requests to the board too purchase new meters, but the Board has denied his requests due to lack of funds. *Id.* at 3:05:25.

In response to questions regarding water theft and providing free water, Mr. Hall responded that he is not aware of Southern ever providing free water in exchange for other services. *Id.* at 2:57:10. Although Southern does not allow anyone to steal water, water theft does occur. *Id.* at 3:10:10. Southern does not have the resources to find and address every instance of water theft. *Id.* Mr. Hall stated Southern simply does not give anyone free water. *Id.* When Southern discovers theft, Southern completely excavates the lines to prevent “jumping.” *Id.* at 4:01:20.

Mr. Hall was also questioned about the transfer of assets to PCUC and the potential to merge with another water district. Mr. Hall testified a merger with a larger utility would not be good for Southern because Southern is uniquely aware of its customers’ needs, and a larger utility would not be. *Id.* at 3:24:40. Southern is aware of the demographics of the area and are able to work with customers more readily, especially those having a difficult time paying their bills. *Id.* Mr. Hall testified that Southern was contacted by Kentucky American Water in the summer of 2018 to potentially manage Southern. He is aware of no ongoing talks with Kentucky American. *Id.* at 3:22:50. Mr. Hall also testified that he objected to the asset transfer proposal from the Fiscal Court and the PCUC because he thought it would burden existing customers. *Id.* at 3:42:45. He did not know the full extent of the impacts resulting from the asset transfer until months after, when Southern’s financials did not improve, and when the KIA would no longer approve funding for two critical infrastructure projects without a rate increase. *Id.* at 3:43:50.

Mr. Hall also testified that he works with the KRWA, specifically Danny Stinson and Tim Blanton, on overall management and operation of the water district, with an emphasis on leak detection and addressing water loss. *Id.* at 3:39:20. He also works with Kentucky Engineering on major infrastructure projects and project funding and has considered hiring Greg Heitzman of Blue Water as a consultant. *Id.*

f. Testimony Summary of Commissioners Osbourne, Hamilton, and Hall

The Commission next called Commissioners Osbourne, Hamilton, and Hale in rapid succession. Each testified that they attended the required initial and continuing education classes with the Commission. The Commission questioned each member on why they voted to approve the transfer of assets to the PCUC. Mr. Osborne responded that at the time of negotiations, the Board was informed that the agreement would be a “win-win,” but it was not. *Id.* at 4:31:40. He stated, he voted for the transaction, but it was a reluctant vote. *Id.* at 4:32:06. Mr. Osborne also testified that the area of the district were water customers and infrastructure were transferred had the best infrastructure. *Id.* at 4:33:50.

Mr. Hamilton testified that he was not in favor of the agreement, but voted for it because the Judge Executive lobbied for it. *Id.* at 4:44:35. He did not feel beholden to the Judge Executive, but was convinced to vote in favor of it. *Id.* at 4:47:20. If given the chance, Mr. Hamilton would vote to rescind the asset transfer agreement. *Id.* at 4:49:23.

Mr. Hall testified that during the discussion regarding the transfer of assets, he was open minded, but was encouraged to sell the sewer assets. *Id.* at 5:00:00. He believes now that the agreement was not a win-win, because Southern is continuing to lose money every month. *Id.* at 5:02:15.

g. Testimony Summary of Tim Blanton, KRWA

Mr. Blanton was questioned on how he provides assistance to Southern. He testified that he has been working with Southern for almost eleven years and assists them with meter testing, leak detection, district optimization, water auditing and general management issues. Mr. Blanton testified that Southern was “no worse, no better than most, better than many” when asked how Southern compared to other water districts he has worked with. *Id.* at 5:16:41. He added,

“Staffing-wise and equipment and warehousing and having the materials on hand to do the job necessary. Majority of utilities I go to can’t say that. They can.” *Id.*

h. Testimony Summary of Danny Stinson, KRWA

Mr. Stinson was also questioned on how he provides assistance to Southern. Mr. Stinson testified about the leak protection plan: “Well I thought if they had a written plan and that they could refer to it at later times it could be real helpful to them. With 22 tank zones you really need to have a plan where you can assess your whole system on a daily basis rather than waiting a whole month and potentially losing water you would lose in 30 days when you can lessen the amount of time it’s leaking.” *Id.* at 5:21:35. When asked about the improvements he has seen since the implementation of the leak detection plan, Mr. Stinson replied:

Yeah. You know it takes a little time for people to get used to operating a little differently, but I can tell you there’s one tank zone in particular, the Spurlock tank zone, which, initially, a tank draw showed that it had approximately 150 gallons per minutes excess flows. So we went out and verified that with a flow meter. It wasn’t that, but it was still 140 gallon a minute.... I trained Reece Sawyer how to operate a flow meter so he could validate what we was seeing at the plant, and then his guys were trained on how to make sure that valve was shut off when we shut it off and interpret the results back at the flow meter. So say it’s flowing 150 gallons when we shut this valve off, well if you have 10 customers past that valve and you see a 10 gallons per minute decrease on that flow meter. Well that was next step and they were able to do that. They were able to isolate all of the excess flow. Then the next step was to pinpoint the leaks with their acoustic devices, which they were successful in doing as well. I figured it up; of the total water loss, the water they recovered, just in that zone, I believe it was 14% of their total water loss. Yeah, and they were able to sustain that for 3 weeks, until you know nature of the beast. It’s hard to keep it there, that’s why we all have a job. There’s always something happening.

Id. at 5:21:35. Mr. Stinson also testified that it was his expectation that if they follow their Leak Detection Plan, he has no doubt that Southern will see substantial improvements in water loss.

Id. at 5:30:54.

i. Testimony Summary of Holly Nichols, Kentucky Engineering

Holly Nichols is a project administrator for Kentucky Engineering. She works closely with Southern on different infrastructure projects and loan applications. She also assisted Southern with this rate case application. Ms. Nichols testified that she calculated the number used by Mr. Fyffe in his October 2018 appraisal of assets transferred from Southern to the PCUC. The calculation was performed as part of the rate adjustment application filed in June 2018 to determine the amount of income lost due to the transfer of water customers *only* to the PCUC.

6. Post Hearing Requests for Information

Shortly after the January 8, 2019 hearing, the Attorney General and the Commission filed Post Hearing Requests for Information. Southern timely filed those responses on January 16, 2018.

II. ARGUMENT

A. THE COMMISSION'S CALCULATED RATE BASE IS REASONABLE

As stated above, Southern's application sought the Commission's approval of an increase in its annual revenues of \$953,409 and total revenues from service rates of \$3,831.896, an increase of 33.12%. Southern proposed to allocate the rate increase among its retail customers. The Commission generally agreed with Southern's calculations, but took exception to many items mainly related to water loss and unauthorized debt. *See Section I(B)(2), supra.* The Commission Staff also found Southern's adjustments for lost revenues of \$656,122 and loss of 60,744,000 gallons previously sold to the transferred 1,160 customers are reasonable and should be accepted by the Commission. In the end, after adjustments for water loss, unauthorized debt, tap fee accounting, depreciating assets, sales tax accounting, and allowance for working capital, the Commission found that Southern's Overall Revenue Requirement is \$4,201,262, and

that a \$1,110,415 revenue increase, or 37.87%, to pro forma rate revenues is necessary to generate the Overall Revenue Requirement. The Commission spread the rate increase across all of Southern’s customers as follows:

Staff Calculated Monthly Rates			
First	2000 gallons	\$33.92	Minimum Bill
Over	2000 gallons	\$11.58	per 1,000 gallons
Wholesale Customers			
City Hindman		\$3.78	per 1,000 gallons
Knott County Water District		\$3.86	per 1,000 gallons
City of Wheelwright		\$3.75	per 1,000 gallons

Southern accepted the Staff Report with no objections, as well as the rates developed by the Commission Staff. Thus, the Commission should approve the requested increase in rates to ensure that Southern is afforded the fair, just and reasonable rates to which it is entitled.⁸ Without a rate increase, Southern will not have the income to continue its work in detecting water loss, replacing aging infrastructure, and repairing certain water assets that could pose a danger to residents.

B. CONCERNS WITH WATER LOSS

Both the Commission and the Attorney General expressed concern about Southern’s water loss. Unfortunately, with the geologic and topographic features common in Eastern Kentucky, along with a declining population, and a substantial portion of the customer base impacted by poverty and depressed socio-economic conditions, finding the resources and funding to address an aging water system is difficult. Yet, as indicated by the testimony of Dean Hall, Tim Blanton, and Danny Stinson, Southern has taken proactive and successful steps to

⁸ While the Commission staff disregarded Southern’s calculations for flushing and fire department water use, testimony by Tim Blanton and Danny Stinson demonstrate those methodologies used for the calculations are widely accepted in the industry as reasonable alternatives. Those totals were calculated to be: 12,000,000 gallons for flushing and 9,429,513 for fire department use for the 2016 test year. *See* fn. 4 above.

address many of its water loss issues. While Mr. Hall and Mr. Blanton both agreed that water loss will never be 0% and probably never 15% absent total replacement of the entire water system, Southern is “better than many” and if Southern follow their Leak Detection Plan, there is no doubt that Southern will see substantial improvements in water loss. *See Section I(B)(5)(g)-(h), supra.* In addition, a rate increase will provide the finances needed to secure a loan from the KIA to fund a major infrastructure project that will provide much needed water loss relief. That loan is currently on hold pending this rate case.

C. CONCERNS WITH UNAUTHORIZED DEBT

Southern’s Board made a mistake by failing to seek approval for loans that exceeded five years in violation of KRS 278.300. The Board recognized its mistake, and through the testimony of Chair Paula Johnson, apologized. The Commissioners first learned of their mistake after attending the Commission’s continuing education conference. The Board never intentionally violated the statute. It is working with its CPA and is in the process of adopting policies to ensure that the proper approval from the PSC is sought prior to acquiring any future debt.

D. CONCERNS WITH THE TRANSFER OF ASSETS AND MERGER

As discussed above, the Asset Purchase Agreement and the Joint Application to transfer assets as approved by the Commission is complicated and somewhat problematic. However, as Southern, the PCUC, the City of Prestonsburg, the Floyd County Fiscal Court, and the USDA RD work through those issues, Southern is still in dire need of a rate adjustment. In addition, neither Southern nor the PCUC believed the two entities should merge. *See Testimony Summaries of Turner Campbell and Dean Hall, supra.* Throughout the January 9, 2018 hearing, the Commission admonished Southern’s Board to come to the Commission when it needs help. Southern has done so. As the Commission Staff has proposed, consistent with Southern’s

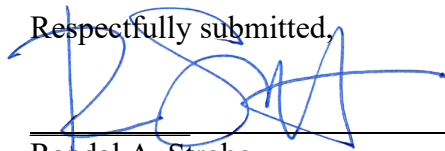
application, Southern is entitled to fair, just and reasonable rates as calculated by the Commission.

III. CONCLUSION

Although the Commission took issue with the way in which Southern's Board of Commissioners made certain decisions, Southern is taking the steps to receive the help it needs from the Commission and outside consultants such as the KRWA and Kentucky Engineering, and is already seeing substantial improvements in water loss. With regards to its rate adjustment application, Southern has met its burden of proof with respect to demonstrating that its operation and maintenance expenses are prudent and reasonable.

The rate adjustment proposed is critically important to Southern, as it will enable and incentivize Southern to increase the replacement rate of failing water lines and other infrastructure and will continue to allow Southern to take proactive action towards leak detection. Southern will not survive incurring its current monthly losses and desperately needs rate adjustment assistance from this Commission. Southern respectfully requests that the Commission approve the requested increase in rates to ensure that Southern is afforded fair, just and reasonable rates.

Respectfully submitted,

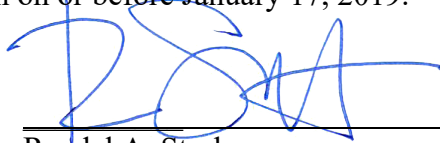


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CERTIFICATE OF SERVICE

In accordance with 807 KAR 5:001, Section 8, I certify that the Applicant's electronic filing of this Response is a true and accurate copy of the same document being filed in paper medium; that the electronic filing was transmitted to the Public Service Commission on January 17, 2019; that there are currently no parties that the Public Service Commission has excused from participation by electronic means in this proceeding; and that an original paper medium will be delivered to the Public Service Commission on or before January 17, 2019.



Randal A. Strobo
STROBO BARKLEY PLLC

EXHIBIT 1

2016 Fire Department Water Use			
Month	Water Sales (gal)		Total (gal)
January	26,050,000	x (.3)	781,500
February	27,647,000	x (.3)	829,410
March	23,482,000	x (.3)	704,460
April	26,271,000	x (.3)	788,133
May	26,560,000	x (.3)	796,800
June	29,996,000	x (.3)	899,880
July	30,162,000	x (.3)	904,860
August	23,709,000	x (.3)	711,270
September	26,840,000	x (.3)	805,200
October	23,750,000	x (.3)	712,000
November	27,369,000	x (.3)	821,000
December	22,523,000	x (.3)	675,000
		Total	9,429,513 gal

2016 Flushing Water Use

- 8 fire hydrants flushed per day through 25" hose nozzle @ 250-300 gallons per minute, for 15-20 minutes each, multiplied by 30 days, or:

$$(8)(250)(15)(30) = 900,000 \text{ monthly flushing usage (min)}$$

$$(8)(300)(20)(30) = 1,440,000 \text{ monthly flushing usage (max)}$$

- Estimated at 1,000,000 per month
- Total = 1,000,000 x 12 = 12,000,000 gallons/year