

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

PROPOSED ADJUSTMENT OF THE WHOLESALE)
WATER SERVICE RATES OF THE CITY OF) Case No. 2019-00080
PIKEVILLE TO MOUNTAIN WATER DISTRICT)

**PETITION FOR REHEARING BY
CITY OF PIKEVILLE**

Pursuant to KRS 278.400, the City of Pikeville, by counsel, petitions the Public Service Commission of Kentucky (“Commission”) for rehearing of its December 19, 2019, Order (hereinafter “Order”). In support of this Petition, Pikeville states the following:

- I. The Commission’s order is unlawful, as it requires Pikeville to change its rate to Southern Water and Sewer District without the Commission complying with statutory provisions and constitutional protections.**

The Commission’s Order violates statutory and constitutional law. Months before this investigation into the wholesale water rate to Mountain Water District (“MWD”) was established, the Commission approved on October 16, 2018, a wholesale water rate of \$2.25 per 1,000 gallons to Southern Water and Sewer District (“Southern District”). In its Order dated December 19, 2019, the Commission ordered Pikeville to charge a wholesale water rate of \$1.97 per 1,000 gallons to Southern District. The Commission further ordered that the rate to Southern be made effective on September 5, 2019, thereby attempting to require Pikeville to refund some of the revenue it collected from Southern District.

The case pending before the Commission, however, was not an investigation of Pikeville’s rate to Southern District. Rather, the case related exclusively to the rate Pikeville

would charge MWD. When Pikeville filed its initial tariff and materials with the Commission on February 21, 2019, Pikeville was only proposing to change the rate to MWD.

The fact that the underlying case only related to the rates charged to MWD is demonstrated by the Commission's orders. In the Commission's initial order issued on March 28, 2019, the Commission determined that that an investigation was necessary to determine the reasonableness of the proposed rates to MWD. In that order, the Commission suspended the effectiveness of the rate only to MWD. Similarly, it made only Pikeville and MWD parties to the case. Even the style of the case—Proposed Adjustment of the Wholesale Water Service Rates of the City of Pikeville to Mountain Water District—indicates that the only rate that the Commission was investigating was for water provided to MWD. At no point in time did the Commission issue an order suspending the rate to Southern District or making Southern District a party to the case.

The Commission repeated these facts in the subsequent order dated June 10, 2019, that established the initial procedural schedule in this case. It stated:

On February 21, 2019, the city of Pikeville (Pikeville), through counsel, filed with the Commission a revised tariff sheet setting forth proposed adjustments to its existing rates for wholesale water service to Mountain Water District (Mountain District), effective April 5, 2019. On March 4, 2019, Mountain District, through counsel, submitted a letter requesting that the Commission open a formal proceeding to investigate the reasonableness of the proposed rate, establish a procedural schedule, and ensure that the proposed rate is not placed into effect before the Commission conducts a hearing. The Commission issued an Order on March 28, 2019, establishing a formal proceeding, suspending the rates until September 4, 2019, making Mountain District a party to the proceeding and providing others until April 15, 2019, to intervene.

Notably, no mention of Southern District arises in the Commission's order.

It was not until the final order dated December 19, 2019, in which the Commission attempted to change Pikeville's rate to Southern District that the Commission had previously approved. The Commission's process in attempting to change Pikeville's rate to Southern District does not comply with statutory law.

KRS 278.200 mandates that the Commission adhere to the provisions of KRS Chapter 278 prior to attempting to change a rate or service standard set by contract between a city and utility. In addition, it forbids any such change "until a hearing has been had before the commission in the manner prescribed in this chapter." KRS 278.200. In summary, the Commission does not have jurisdiction over a change in rates unless it complies with the provisions of KRS Chapter 278.

KRS 278.180 states that a utility must give 30 days' notice to the Commission prior to any increased rate change. This notice given at least 30 days in advance must contain information "stating plainly the changes proposed to be made and the time when the changed rates will go into effect." KRS 278.180(1). The statute then states, "The commission may order a rate change only after giving an identical notice to the utility."

In the present case, the Commission did not give any notice to Pikeville indicating that the Commission would propose changes to the rate Pikeville charges Southern District. Moreover, the Commission attempts to make the change retroactive to September 5, 2019. This would require a rate change to revert back 105 days prior to any proposal by the Commission that it be changed.

The Commission's attempted action is also inconsistent with KRS 278.270, which states:

Whenever the commission, upon its own motion or upon complaint as provided in KRS 278.260, and after a hearing had upon reasonable notice, finds that any rate is unjust, unreasonable, insufficient, unjustly discriminatory or otherwise in violation of

any of the provisions of this chapter, the commission shall by order prescribe a just and reasonable rate to be followed in the future.

This statutory provision is clear. In order for the Commission to prescribe a just and reasonable rate, there must be (1) reasonable notice,¹ (2) a hearing, (3) a finding that the rate is unjust, unreasonable, insufficient, unjustly discriminatory or otherwise in violation of KRS Chapter 278, and (4) a determination of a just and reasonable rate to be followed *in the future*.

In attempting to change Pikeville's rate to Southern District, the Commission failed to comply with any of these four requirements. The Commission failed to provide any notice that it was proposing a change to Pikeville's rate to Southern District. The Commission did not hold a hearing on Pikeville's rate to Southern District. The Commission did not make a finding that the rate to Southern was unjust, unreasonable, insufficient, unjustly discriminatory or otherwise in violation of KRS Chapter 278. And the Commission attempted to order Pikeville's rate to be retroactively applied.

In a recent case, the Court of Appeals verified that such retroactive rate adjustments are not allowed, stating: "This statute [KRS 278.270] can only be understood as authorizing only prospective, and not retroactive, rate adjustment." Sprint Communications Company, L.P. v. Brandenburg Telephone Co., 2017-CA-000534-MR, 2019 WL 4565546, at *5 (Ky. App. Sept. 20, 2019). That court specifically held, "Retroactive application of the PSC's adjustment of the tariff is unlawful because it exceeds the PSC's legislative authority for rate making and rate adjustment." Id. In Pikeville's case, the Commission attempted to have retroactive application of a rate, which the Court of Appeals has determined to be unlawful.

The Commission attempts to require Pikeville to refund certain amounts collected from Southern District for water sold after September 5, 2019. The Court of Appeals found a similar

¹ The general "reasonable notice" requirement of KRS 278.270 should be construed consistent with the specific notice requirement set forth in KRS 278.180.

situation to be unlawful in Cincinnati Bell Telephone Co. v. Kentucky Public Service Com'n, 223 S.W.3d 829 (Ky. App. 2007). That appellate case was the culmination of a series of underlying proceedings before the Commission, which were impacted by decisions of the Federal Communications Commission (“FCC”). Those proceedings were based on the fact that the telecommunication companies had collected revenue from independent payphone service providers pursuant to a rate established in prior PSC proceedings. Id. at 831-32. A consortium of independent payphone service providers operating in Kentucky argued that the rates established in the telecommunication companies’ tariffs failed to comply with the tariff guideline of the new services test established by the FCC. The Commission agreed with the independent payphone service providers, and in June 2003, ordered the telecommunication companies to refund certain revenues based on a retroactive effective date of January 31, 2002. Id. at 835.

On appeal, the Court of Appeals determined that the Commission’s order requiring refunds was unlawful. After quoting relevant statutes including KRS 278.180 and KRS 278.270, the Court explained that “the filed rate can only be lawfully altered **prospectively.**” Id. at 839. It further found “as a matter of law, BellSouth [in addition to the other telecommunication companies] was never overpaid; no credits accrued; and no refunds were owed.” Id. at 839.

Pikeville’s rate to Southern District in the present case has similarities² to the telecommunication companies’ rate to the members of the consortium of independent payphone service provider in Cincinnati Bell Telephone. Pikeville’s rate to Southern has been the filed rate since October 16, 2018. Pikeville issued bills based on that rate, and as a matter of law, Pikeville was never overpaid by Southern; no credits accrued; and no refunds were owed.

² The primary difference between the two cases relates to notice to the utilities. In Cincinnati Bell Telephone, the telecommunication companies understood that their rates to certain customers were being investigated by the Commission. Pikeville, however, had no knowledge that the Commission would attempt to change its rate to Southern District.

In addition to conflicting with Kentucky statutes, the Commission's decision violates Pikeville's constitutional due process rights related to its rate to Southern District. Kentucky's highest court has clearly supported such a decision, stating: "Aside from the provisions of our own statutes on the subject, constitutional due process requires a fair and open hearing as prerequisite to an order reducing rates of a public utility." Mayfield Gas Co. v. Public Service Com'n, 259 S.W.2d 8, 10 (Ky. 1953) (citing Ohio Bell Telephone Co. v. Public Utilities Com'n of Ohio, 301 U.S. 292 (1937)). The United States Supreme Court has likewise provided a detailed explanation of due process mandates:

A party is entitled, of course, to know the issues on which decision will turn and to be apprised of the factual material on which the agency relies for decision so that he may rebut it. Indeed, the Due Process Clause forbids any agency to use evidence in a way that forecloses an opportunity to offer a contrary presentation.

Bowman Transp., Inc. v. Arkansas-Best Freight System, Inc., 419 U.S. 281, 289 n.4 (1974)(citing Ohio Bell Telephone Co. v. Public Utilities Com'n, 301 U.S. 292, (1937); United States v. Abilene & S.R. Co., 265 U.S. 274 (1924)).

In the present case, Pikeville was never apprised that the Commission would consider changing the rate to Southern District. And without notice of the issues to be considered, there was never a fair and opening hearing on Pikeville's rates to Southern District. Accordingly, the Commission's decision to reduce Pikeville's rate to Southern District violates constitutional due process requirements. See Mayfield Gas Co., 259 S.W.2d at 10.

It is also worth considering the legal implications if the Commission had determined that the Pikeville's rate to MWD and Southern District should be the same but approved Pikeville's proposed rate to MWD of \$2.30 to be effective September 4, 2019. Southern District would have had no notice that the rate it was charged by Pikeville was potentially increasing. It is

unfathomable that the Commission would allow an increase without notice to its customers who would be impacted by that increased rate. In fact, on several occasions the Commission has anticipated approval of higher-than-proposed rates for a utility, but it only allowed the utility to adopt the higher-than-proposed rate after providing additional public notice and opportunity to be heard. See, e.g., W. McCracken Cnty. Water Dist., Case No. 2017-00319 (Staff Report Oct. 30, 2017 and PSC Orders Dec. 8, 2017 and Jan. 30, 2018); E. Pendleton Cnty. Water Dist., Case No. 2013-00103 (Staff Report June 28, 2013 and PSC Orders Aug. 1, 2013 and Oct. 24, 2013).

In summary, the Commission's Order regarding Pikeville's rate to Southern District violates statutory and constitutional law. In order to correct the Commission error, the Commission must declare that its attempt to decrease Pikeville's rate to Southern District is void, that the rate to Southern District is \$2.25 per 1,000 gallons, and that Pikeville is not required to refund any amounts to Southern District.

II. Revenue Requirement Adjustments

The following modifications impacting revenue requirements should be made to the Commission's Order.³

A. The Commission should data from test year for its Customer Allocation Factor.

In its Order, the Commission determined that certain expenses that it determined to be fixed shared costs for the inside- and outside-city customer classifications should be allocated to each classification based on a Customer Allocation Factor.⁴ In making this calculation, the Commission utilized a five-year average of customers, instead of using the customer count for the test year on which the expenses are based. This adjustment violates the "matching principle"

³ Pikeville does not agree with other adjustments made by the Commission, but has chosen not to request challenge those adjustments for this request for rehearing.

⁴ Order at 8.

Historical test year ratemaking is premised on the “matching principle” of accounting, where the relationship of revenues and expenses is established. “For ratemaking purposes, the matching principle means that all revenues, expenses, rate base components, plant additions, and capital items are updated to the same period.” S. Kentucky Rural Elec. Coop. Corp., Case No. 2011-00096, 2012 WL 1133707 (Mar. 30, 2012).

By applying a customer allocation factor that is based on an average calculated with customer data from 2014 to 2018 to expenses from Fiscal Year 2017, the Commission has failed to match all expenses from Fiscal Year 2017. The product of multiplying the Commission’s customer allocation factor with expenses from Fiscal Year 2017 does not establish a recoverable expense that is based on that five-year average, not the test year on which all other expenses are based.

In its Order, the Commission has cited a number of cases in which it has supported a customer allocation factor to apply to shared costs.⁵ None of these cases state that the Commission or its Staff is utilizing a multi-year average to determine the appropriate allocation factor.⁶

In order to correct this error, the Commission must acknowledge that the Customer Allocation Factor should be calculated by utilizing data exclusively from Fiscal Year 2017. This adjustment will result in the customer allocation factor for the outside-city system to be 33.253 percent and the factor for the inside-city system to be 66.747 percent.⁷

⁵ These cases are identified in footnote 29 on page 8 of the Order.

⁶ See, e.g., Symsonia Water Dist. Case No. 2017-00371 at 7 n.11 (Staff Report issued Jan. 3, 2018)(calculating the customer allocation factor based on the 2016 test-year data); W. Lewis Rectorville Water and Gas Dist. Case No. 2017-00074 at 5 n.7 (Staff Report issued July 17, 2017)(calculating the customer allocation factor based on the 2015 test-year data); Garrison-Quincy-Ky-O Heights Water Dist. Case No. 2013-00350 at 6 n.8 (Staff Report issued Jan. 3, 2018)(calculating the customer allocation factor based on the 2016 test-year data).

⁷ It appears that this adjustment will impact the following expenses: Insurance, UMG Mgt Fee, UMG Services, Repairs/Maintenance, Repairs and Maintenance Plant, and Depreciation.

B. The Commission should be consistent with its adjustments for expenses that it determines to be fixed shared costs and, therefore, include total expenses for Repairs and Maintenance Plant prior to applying an allocation factor.

In its adjustments to reallocate expenses that the Commission determined to be shared fixed costs, the Commission typically started its adjustment based on the total inside-city and outside-city expense.⁸ For example, the adjustment for the UMG Management fee is based on the total amount of the expense of \$1,671,184.⁹ Similarly, the Commission added inside-city and outside-city expenses for insurance prior to applying the Customer Allocation Factor.¹⁰

The Commission, however, only used the inside-city expenses for Repairs and Maintenance Plant before applying the Customer Allocation Factor.¹¹ In other words, it failed to add the outside-city allocated expenses before applying that factor.

The outside-city expenses for Repairs and Maintenance Plant were produced in Pikeville's Supplemental Response to Item 8a of the Commission Staff's First Request for Information. The sum of the outside-city allocated expenses for Ross Valve Manufacturing, Eco Lab, and ML Johnson totals \$1,888. This amount should be added to the calculation for Repairs and Maintenance Plant.

Similarly, the Commission should correct certain formulas for calculating each adjustment to fixed shared costs. This correction to the formulas would impact the Insurance Expense and the Repairs and Maintenance Plant Expense. For example, the formula utilized in footnote 31 suggests an downward adjustment of \$11,663, but applying that amount to the reported inside-city expense for Fiscal Year 2017 would not account for the expense (\$5,762) that the City allocated to the outside-city system and that the Commission included in its

⁸ Order at 9.

⁹ Id. at n.32.

¹⁰ Id. at n.31.

¹¹ Id. at n.35.

calculation. The adjustment for Insurance Expense and Repairs and Maintenance Plant Expense would be as follows:

$$\begin{aligned} & \$29,134 \text{ (Reported Inside City)} + \$5,762 \text{ (Allocated Outside City)} = \$34,896 \times (66.747\%) \\ & \text{(Customer Allocation Factor)} = \$23,292 \text{ (Amount to be recovered in Pro Forma Operations)} \\ & \$23,292 - 29,134 \text{ (Reported Inside City)} = \mathbf{(\$5,842)} \text{ (Reallocation adjustment)} \end{aligned}$$

$$\begin{aligned} & \$30,632 \text{ (Reported Inside City)} - \$24,264 \text{ (Nonrecurring costs)} + \$1,888 \text{ (Allocated} \\ & \text{Outside City)} = \$8,265 \times (66.747\%) \text{ (Customer Allocation Factor)} = \$5,511 \text{ (Amount to be} \\ & \text{recovered in Pro Forma Operations)} \\ & \$5,511 - \$30,632 - \$24,264 = \mathbf{(\$857)} \text{ (Reallocation adjustment)} \end{aligned}$$

These corrected formulas will ensure that Pikeville can recover these expenses from inside-city customers based on the Commission's determination that they should be applied to a Customer Allocation Factor.

C. The Commission should calculate Pikeville's recoverable electric expense based on water sales based on the test year.

In its Order, the Commission determined how much electric expense Pikeville should be recovered from inside-city customers by using a five-year average of water produced and sold.¹² There are at least two errors in the Commission's formula.

First, the Commission attempts to calculate a cost per gallon for electric expense based on average water production, as opposed to water sales. But, in determining the electrical expense to be recovered in rates the Commission only multiplies that cost per gallon to water sales. This formula leaves a void, whereby Pikeville would be unable to recover for electric expense associate with water produced but not sold.

¹² Order at 9-10.

The following table shows this error. Specifically, it shows that if the Commission’s formula is also applied to outside sales, Pikeville would only recover \$275,718 out of the \$343,036 total electrical expense,¹³ leaving an unrecoverable electric expense of \$67,459.

	PSC Inside Calculation	PSC Outside Calculation (Implied)	PSC Implied Unrecoverable Electric Expense
Reported Electric Inside City	\$ 299,596	\$ 299,596	\$ 299,596
Add: Electric Expense Allocated Outside City:			
Treatment Plant	43,440	43,440	43,440
Total Electric Expense	343,036	343,036	343,036
Divided by: Average Water Production	1,221,449,560	1,221,449,560	1,221,449,560
Electric Cost per Gallon	0.000281	0.000281	0.000281
Multiplied by: Average Inside Water Sales	901,310,007	79,938,426	240,201,127
Reallocated City Electric Expense	\$ 253,268	\$ 22,450	\$ 67,459

In order to correct this error, the Commission must utilize Total Water Sales, in lieu of Average Water Production.

Second, the Commission attempts to calculate a cost per gallon for electric expense based on expenses for Fiscal Year 2017 applied to a five-year average of data for water production and water sales. As discussed above, the application of a factor based on a five-year average to expenses from one specific year violates the matching principle.

The violation of the matching principle in this scenario is particularly relevant to electric expenses because these are variable expenses. As this Commission has recognized, “[e]lectricity cost incurred for pumping will vary depending on the amount of water produced and purchased.” Hardin County Water Dist. No. 1, Case No. 2001-00211 (Ky. PSC. Mar. 1, 2002). In other words, electric expense is likely to increase based on an increase in water production and sales.

¹³ The Commission’s calculation for “Total Electric Expense” is calculated based on adding Fiscal Year 2017 inside city electrical expense with electrical expense allocated to outside city for treatment plant. Pikeville had additional expense assigned to the outside-city system that was not included in this calculation.

Thus, in order to have an apples-to-apples comparison to calculate a cost per gallon, both the numerator and denominator must be based on data from the same time period.

In order to correct the Commission’s error, the divisor cannot be based on a five-year average. Rather, it must be based on Fiscal Year 2017 data. The table below reflects the appropriate changes to both necessary corrections identified above.

	Inside City Calculation
Reported Electric Inside City	\$ 299,596
Add: Electric Expense Allocated Outside City:	
Treatment Plant	43,440
	<hr/>
Total Electric Expense	343,036
Divided by: FY 2017 Total Water Sales	973,385,317
	<hr/>
Electric Cost per Gallon	0.000352
Multiplied by: Inside Water Sales	900,812,417
	<hr/>
Reallocated City Electric Expense	\$ 317,460
Less: Reported Electric Expense	-299,596
	<hr/>
Pro Forma Adjustment	\$ 17,864

This table demonstrates that the appropriate pro forma adjustment to inside-city electrical expense reported by Pikeville should be an increase of \$17,864 instead of a decrease of \$46,328.

D. The Commission should make several corrections to the customer-related-cost adjustments that it determined were appropriate.

In its Order, the Commission identified certain expenses that it determined were customer-related costs.¹⁴ Without explaining its rationale, the Commission stated that some customer-related costs “should be totally recovered from the retail water customers.”¹⁵ In addition, the Commission determined that other customer-related costs should be allocated based on a factor calculated from the number of meters in Pikeville’s system. Several corrections must be made to the customer-related-cost adjustments that the Commission determined were appropriate.

First, there is no evidence to support the Commission’s decision that expenses for Salaries & Wages, Workers Comp, Employee Benefit Insurance, Pension Matching, Payroll Tax, and Unemployment Tax should be recovered exclusively from the retail customers. As described in Pikeville’s Responses to Item 6 of the Commission’s Staff’s First Request for Information, these expenses are related only to two Pikeville employees who perform the following duties: customer service, phone calls, new service applications, work orders, receipt of payments, and utility billing. These duties are directly related to providing wholesale water service to MWD. Specifically, these two employees are available to take calls from MWD, they prepare work orders for maintenance of facilities that benefit MWD, send bills to MWD, and receive payments from MWD. There is no evidence in the record to reject recovery of a portion of these expenses.

Second, the Commission erroneously calculates the allocation factor for customer-related costs based on Pikeville having 9 wholesale water meters. As shown in Pikeville’s Response to Item 16 of the Commission Staff’s First Request for Information, Pikeville has 11 master meters

¹⁴ Order at 11.

¹⁵ Id.

serving MWD.¹⁶ This correction would increase the allocation factor to MWD for customer-related costs from 0.181 percent to 0.221 percent.

Third, the Commission eliminated recovery of certain UMG Management Fee expenses twice. The Commission determined that the overall UMG Management Fee expense of \$1,671,185 was reasonable.¹⁷ The Commission determined that the amount of the UMG Management Fee expense that could be recovered from the inside-city system should be based on the Customer Allocation factor.¹⁸ Accordingly, the Commission reduced the UMG Management Fee expense that could be recovered from the inside-city system from \$1,162,040 by \$49,416 to a total of \$1,112,624.

The Commission then determined that the portion of the UMG Management Fee expense for inside-city customers related to administrative costs should be classified as customer-related costs, and accordingly recovered from MWD based on the allocation factor for customer-related costs.¹⁹ In doing so, the Commission started this calculation based the amount determined by Samuel “Buddy” Petty in his Cost of Service Analysis to be related to administration. This administration component was calculated by multiplying 5% of \$1,162,040, which is the UMG Management Fee expense Pikeville assigned to inside-city customers. That calculation resulted in \$58,102 of inside-city expense for administration related to the UMG Management Fee.

In order to reconcile the Commission’s initial determination that there is a reduction of the UMG Management Fee expense that could be recovered from the inside-city system from \$1,162,040 by \$49,416 to a total of \$1,112,624, the Commission must make a corresponding

¹⁶ These meters are (1) Town Mountain, (2) Chloe Road, (3) Island Creek, (4) Coon Branch, (5) South Mayo Trail (Indian Hills), (6) Hoopwood Hollow, (7) Island Creek Mobile Home Park, (8) Hurricane Creek (Cedar Gap), (9) Cowpen, (10) Smiley Fork, and (11) Hurricane.

¹⁷ Order at 12-19.

¹⁸ Order at 9.

¹⁹ See the table on page 11 of the Order.

adjustment to the customer-related expenses. In other words, the test-year amount for inside-city expense for administration related to the UMG Management Fee should be based on 5% of the \$1,112,624. Accordingly, the starting point for the Commission’s adjustment would be \$55,631, instead of \$58,108.

Without this adjustment, the Commission is removing a portion of inside-city UMG Management Fee expense related to administration both (1) when it allocated more expense to the outside-city customers based on the Customer Allocation Factor and (2) when it eliminated customer-related expenses for the UMG Management Fee from inside-city system.²⁰

The adjustments identified in this section are reflected in the table below.

	Test-Year Amounts	Factors	Amounts	Administrative Costs - Retail
Bad Debt Recovery	\$ (290)	0.000%	-	(290)
Water Tap Fee	(24,510)	0.000%	0	(24,510)
Water Penalty	(10,911)	0.000%	0	(10,911)
Operating Revenue	(35,711)		0	(35,711)
Operating Expenses:			0	
Bank Charges-Water Revenue	(3,890)	0.221%	9	(3,881)
Provision For Bad Debt	(1,158)	0.000%	0	(1,158)
Dues	(850)	0.221%	2	(848)
Freight/Postage	(1,349)	0.221%	3	(1,346)
Office Supplies	(2,489)	0.221%	5	(2,484)
Public Works Water - UMG MGT Fee	(55,631)	0.221%	123	(55,508)
Prof Service Other	(777)	0.221%	2	(775)
Ut Monthly Billing/Professional Services	(3,803)	0.221%	8	(3,795)
Rent-Easements	(376)	0.221%	1	(375)
Purchase Software	(1,845)	0.221%	4	(1,841)
Workers Comp	(286)	0.221%	1	(285)
Salaries & Wages	(21,294)	0.221%	47	(21,247)
Employee Benefit Insuranc	(7,567)	0.221%	17	(7,550)
Pension Matching	(8,719)	0.221%	19	(8,700)
Taxes Other Than IncomeTax:			0	0
Payroll Tax	(1,629)	0.221%	4	(1,625)
Unemployment Tax	(127)	0.221%	0	(127)
Operating Expense	(111,790)		244	(111,546)

²⁰ The necessity is further apparent based on the demonstration in Appendix A of the Commission’s order where the UMG Management fee is the only category of expenses in which the Commission decreases for both Administrative Rev/Exp and Reallocation.

The net impact of the adjustments identified above results in an increase to the Commission's Pro Forma Operations and Maintenance expense of \$2,582.

E. The Commission's Order improperly reduces operating expenses for repairs and maintenance without considering other previously expensed costs that should receive similar treatment.

In its Order, the Commission reduced repairs and maintenance expense by \$99,506 after finding that the telemetry repairs at Toller and rehabilitation of the Bob Amos tank should have been amortized as nonrecurring expenses.²¹ It also reduced plant expense by \$24,264 after finding that the repair of a high service pump was a nonrecurring expense.²² It did so by determining that those were nonrecurring expenses that should be amortized and recovered over a 15-year period.

Over the last 15 years, Pikeville has consistently treated similar types of costs as items that should be expensed, instead of amortized. The following list shows similar projects that Pikeville has expensed, rather than amortized.

²¹ Order at 20.

²² Order at 21.

Date	Description	amount	15-year amortization
7/31/2003	repair speed reducer	12,000.00	800.00
11/14/2003	inspect intake	8,420.00	561.33
11/25/2003	repairs water plant	8,770.00	584.67
8/3/2004	component repair	19,700.00	1,313.33
9/24/2004	Fox Croft Tank maintenance	33,000.00	2,200.00
1/19/2005	repair blower	20,000.00	1,333.33
1/11/2006	Smith Hill Tank maintenance	62,000.00	4,133.33
8/18/2006	grit removal	12,018.14	801.21
9/13/2006	grit removal	9,790.94	652.73
1/4/2007	river crossing	28,500.00	1,900.00
4/27/2007	repair flocculator	16,980.00	1,132.00
5/21/2007	toler water maintenance	9,500.00	633.33
6/18/2007	paint Toler	63,500.00	4,233.33
8/14/2009	sandblasted water tank	18,000.00	1,200.00
11/17/2009	exterior/interior dive assessment	4,745.00	316.33
11/18/2009	exterior/interior dive assessment	6,225.00	415.00
12/4/2013	clean inspect 3 tanks	3,480.00	232.00
4/9/2014	cleaned/inspected Cedar Creek and Town Mtn	6,299.00	419.93
10/21/2015	pressure wash and paint ext. 500,000G tank	3,600.00	240.00
12/4/2015	repair concrete mixing tanks, paddles	17,500.00	1,166.67
6/27/2016	motor repairs	10,203.84	680.26
		374,231.92	24,948.79

Because Pikeville has expensed (instead of amortizing) these items that occurred within 14 years of the test year, these expenses would not have appeared in the Operations and Maintenance expenses identified for Fiscal Year 2017 and included in this rate case. But if the Commission has determined that similar expenses within the test year must be amortized over a 15-year period, effectively reducing the revenue requirement for the inside-city system by \$118,206, the Commission should increase amortization expense by \$16,653 to reflect past expensed items that the Commission has determined should be amortized instead of expensed.²³

²³ The amount of \$16,653 is based on the same calculations found in footnotes 78 and 81 of the Commission's order, which applies the Customer Allocation Factor to the amortized expense.

F. The Commission's Order erroneously removed \$47,927 from recovery in rates related to depreciation expense for the inside-city system.

In its Order, the Commission decreased recoverable depreciation expense by \$136,842 to allocate a part of the inside-city system that would be used for outside-city customers.²⁴ This reduction was based on the application of the Customer Allocation Factor to the pro forma depreciation expense of \$409,425.

Later in its analysis, the Commission reduced the total revenue requirement for inside-city customers by the amount of \$60,384 that the City credits for Other Operating Revenue. In this particular case, \$47,927 of the \$60,384 in Other Operating Revenue is the amount Pikeville credits to inside-city depreciation account for the assigned outside-city depreciation expense.²⁵ Because the PSC has already reduced depreciation expense by \$136,842, it would be inappropriate also to include an adjustment for the \$47,927 in Other Operating Revenue that is credited to inside-city revenue from outside-city depreciation.

G. The Commission should correct its calculation errors in calculating the impact on rates from Pikeville's Series 2016A bonds related to the Marion's Branch Water and Sewer Project.

In its Order, the Commission determined that MWD should be responsible for 16.883 percent²⁶ of the debt service for Pikeville's Series 2016A bonds related to the Marion's Branch Water and Sewer Project.²⁷ The Commission's calculation is based on the project cost for storage tank and pump station, but not on general costs, water line, and valves and fittings.²⁸

²⁴ Order at 22.

²⁵ This amount is shown as "Water Plant Cost" in Pikeville's Response to Item 68 of MWD's First Request for Information.

²⁶ Appendix B calculates this percentage as 16.883, but page 26 of the Order erroneously identifies it as 16.833.

²⁷ Order at 26 and Appendix B.

²⁸ Order at Appendix B.

With its decision, the PSC is implicitly saying that MWD would not benefit from the costs for general, water line, and valves and fittings.

There is not substantial evidence in the record to support a finding that MWD does not benefit from the costs for general, water line, and valves and fittings. None of the project could have been completed without general expenses (as with any project). Moreover, evidence in the record demonstrates that Pikeville could not provide service to MWD on infrastructure related to that the tanks and pump station if there was not a water line and valves and fittings. Accordingly, the Commission should determine that MWD is responsible for the 33.333-percent allocation as shown in Appendix B of the Commission's order without any reduction for elimination of MWD's responsibility for general costs, water line, and valves and fittings.

As mentioned above, the Commission determined that MWD should be responsible for 16.833 percent of the debt service for Pikeville's Series 2016A bonds related to the Marion's Branch Water and Sewer Project.²⁹ Regardless of whether MWD's responsibility for the Marion's Branch project is 16.883 percent or 33.333 percent, the Commission must adjust how it applies these percentages when calculating the rate.

Even if one accepts that MWD's responsibility for the Marion's Branch project is 16.883 percent as determined by the Commission, the Commission applied that percentage to the applicable debt service and debt service coverage amounts related to the Marion's Branch project. The resulting debt expense of \$16,133 and debt service coverage \$3,227 were included in the total annual debt principal and interest payments of \$116,499 and debt service coverage of \$23,000.

It is important to remember that the Commission determined that the resulting debt expense of \$16,133 and debt service coverage \$3,227 were the amounts for which MWD should

²⁹ Order at 26 and Appendix B.

be responsible for this project, based on its calculation in Appendix B of its Order. But because the Commission included these amounts in the total revenue requirement and later calculated the revenue requirement for wholesale water rates based on a percentage of sales, the Commission effectively reduced MWD's responsibility from 16.883 percent to 11.599 percent of the project expenses.³⁰

In order to correct these two errors, the Commission should (1) clarify that MWD is responsible for one-third of the project expenses related to Marion's Branch and (2) calculate the impact of that expense to Pikeville's wholesale rate to MWD after other inside-city expenses are allocated to MWD.

H. Summary of Impact of Adjustments on MWD's rate

Based on the above-mentioned adjustments impacting Operation and Maintenance Expense, the applicable Operation & Maintenance Expense should be increased from \$1,421,513 to \$1,498,435.

³⁰ 16.883% (MWD responsibility for project expenses) x 68.7% (percentage of wholesale water sales) = 11.599%

	Fiscal Year Ending	Pro Forma	Administrative		Pro Forma
	06/30/17	Adjustments	Rev/Exp	Reallocations	Operations
Operating Expenses:					
Operation & Maintenance Expense					
Gasoline	144,174	(144,174)			0
BankCharges-Water Revenue	3,890		(3,881)		9
Provision For Bad Debt	1,158		(1,158)		0
Dues	850		(848)		2
Freight/Postage	1,349		(1,346)		3
Insurance	29,134			(5,842)	23,292
Office Supplies	2,489		(2,484)		5
Public Works Water - UMG MGT Fee	1,162,040		(55,508)	(46,575)	1,059,957
Prof Service Other	777		(775)		2
Ut Monthly Billing/Professional Services	3,803		(3,795)		8
Umg...Services	141,565	(23,091)		(39,396)	79,078
Rent-Easements	376		(375)		1
Purchase Software	1,845		(1,841)		4
Repairs/Maintenance	139,077	(129,342)		(3,237)	6,498
Repairs And Maintenance Plant	30,632	(24,264)		(857)	5,511
Telephone/Public Works	8,206	(6,129)			2,077
Electric	299,596			17,864	317,460
City Utilities	4,445				4,445
Workers Comp	286		(285)		1
Salaries & Wages	21,294		(21,247)		47
Employee Benefit Insurance	7,567		(7,550)		17
Pension Matching	8,719		(8,700)		19
Operation & Maintenance Expense	2,013,272	(327,000)	(109,794)	(78,043)	1,498,435

Additional adjustments demonstrated above are reflected in the following table, which reveals the minimum revenue requirement from MWD as \$1,016,066 with a corresponding volumetric rate of \$2.19 per 1,000 gallons.

	Commission Order	Pikeville Rehearing
Operation & Maintenance	\$1,421,513	\$1,498,435
Depreciation	272,583	273,279
Amortization	5,494	22,147
Pro Forma Operating Expenses	1,699,590	\$1,793,861
Plus: Ave. Annual Debt P&I Payments	116,499	100,366
Debt Coverage Requirement	23,300	20,073
Revenue Requirement for Inside City	1,839,389	\$1,914,300
Less: Other Operating Revenue	-60,384	-12,457
Subtotal Excluding Marion's Branch	\$1,779,005	\$1,901,843
% of Wholesale Water Sales	51.4%	51.4%
Allocated Revenue Requirement	\$914,686	\$977,844
Plus: Ave. Annual Debt P&I for MWD's responsibility of 1/3 of Marion's Branch		31,852
Debt Coverage Requirement for MWD's responsibility of 1/3 of Marion's Branch		6,370
Total Revenue Requirement from MWD	\$914,686	\$1,016,066
Divided by Sales to MWD	463,158,000	463,158,000
Wholesale Water Rate to MWD per 1,000 Gallons	\$1.97	\$2.19

III. Rate Case Expense Surcharge

In its Order, the Commission allows Pikeville to recover rate case expense of \$64,394 through a surcharge collected over a 60-month period from both MWD and Southern District. Pikeville requests three modifications to the Commission's order regarding the rate case expense surcharge.

A. Pikeville's rate case expense should be recovered over 36 months.

The Commission should authorize Pikeville to recover these rate case expenses over a 36-month period, as opposed to a 60-month period. There are several reasons for this adjustment. First and foremost, the Commission recognizes that "when there is no evidence to support an alternative amortization period, the Commission amortizes an intangible regulatory asset or liability identified in a rate proceeding over the anticipated life of the utility rates

approved in that proceeding.”³¹ The Commission also acknowledges that “the rates approved in this proceeding will become obsolete after five years due to changes that will likely occur to Pikeville’s cost of providing wholesale water service.”³² It is illogical to maintain that an appropriate amortization period is based on the anticipated life of the approved utility rates, only to set an amortization period ending after those rates have become *obsolete*.

Second, a 36-month amortization period further supports the Commission’s recent emphasis that utilities should evaluate the need for more frequent rate cases. In the electric industry, the Commission established a case in December 2018 in part “to encourage Distribution Cooperatives to make more frequent, smaller rate adjustments.” A Review of the Rate Case Procedure for Electric Distribution Cooperatives, Case No. 2018-00407 (Ky. PSC Dec. 11, 2018).

This same principle has been a major focus of the Commission as it relates to water utilities. In November 2019, the Commission issued its report entitled “Confronting the Problems Plaguing Kentucky’s Water Utilities.”³³ The very first paragraph of the section in that report discussing “Poor Financial and Accounting Practices” relates to “Infrequent Rate Increases.”³⁴ The Commission specifically stated:

[B]oards and managers of small, rural water utilities will take extraordinary steps to avoid coming to the Commission for a rate increase, opting instead to try and operate on razor-thin margins. A utility that fails to increase revenues to match rising expenses cannot maintain its financial integrity, especially over the long-term. Moreover, when a utility delays increasing rates by covering

³¹ Order at 34-35.

³² Id. at 35.

³³ This report was filed into the record in Electronic Investigation into Excessive Water Loss by Kentucky’s Jurisdictional Utilities, Case No. 2019-00041 (Ky. PSC Nov. 22, 2019).

³⁴ Report at 16.

operational expenses with depreciation reserves or through other funding mechanisms, true financial needs are masked.³⁵

By requiring Pikeville to amortize its rate case expense over a five-year period, instead of a three-year period, the Commission is signaling that rate cases need not be filed more frequently than every five years. Such a signal appears to be inconsistent with the Commission's encouragement that "[e]ach water utility should evaluate the need for more frequent rate cases."³⁶

Third, there is no ability for Pikeville to "over-recover" with the surcharge mechanism. When rate case expense is built into a volumetric rate, there is incentive to use an amortization period that is consistent with the anticipated rate case cycle of a particular utility. If the utility is permitted to amortize the expense over a shorter period than when it next files a rate case, the utility would (in theory) over-recover on that single expense that is built into a rate that is set for an indefinite period. The surcharge, however, is limited to a set number of months. Pikeville will not be able to "over-recover" because the term of the surcharge will expire when Pikeville recovers the full amount.

Accordingly, the Commission should approve Pikeville's recover of rate case expenses over a 36-month period.

B. Pikeville's rate case expense surcharge should be recovered only from MWD.

The Commission ordered Pikeville to charge its rate case expense surcharge to both MWD and Southern District. As discussed above, the Commission's order amending the rate to Southern District is contrary to statutory and constitutional law. From the outset of this case, it

³⁵ Id.

³⁶ Order, Case No. 2019-00041 at 7.

was only an investigation into Pikeville’s wholesale water rates for MWD. As a matter of principle,³⁷ it is only appropriate to charge the rate case expense surcharge to MWD.

C. The Commission should allow Pikeville to recover additional rate case expense for the prosecution of this request for rehearing.

The Commission has acknowledged that “[i]t is a well-settled principle of utility law that rate case expenses ‘must be included among the costs of operation in the computation of a fair return.’”³⁸ Likewise, it has stated that a utility is entitled “to recover all prudent and reasonable rate case costs.”³⁹

The Supreme Court of the United States has also supported recover of rate case expense. In Driscoll v. Edison Light & Power Co., 307 U.S. 104, 120 (1939), a regulatory agency refused to allow rate case expense to be recovered on the grounds that the utility was defending “obviously excessive” rates. The Court rejected the agency’s decision, stating: “Even where the rates in effect are excessive, on a proceeding by a commission to determine reasonableness, we are of the view that the utility should be allowed its fair and proper expenses for presenting its side to the commission.” Id. at 120-121.

Likewise, Pikeville should be allowed its fair and proper expenses for presenting its side to this Commission. Accordingly, Pikeville should be permitted to increase rate case expense based on the costs of prosecuting this Petition for Adoption. It will provide supporting documentation of rate case expense upon the granting of the Petition for Rehearing.

IV. Conclusion

For the foregoing reasons, Pikeville respectfully requests an order granting Pikeville’s Petition for Rehearing on the above-mentioned issues and modify its Order accordingly.

³⁷ Pikeville notes that this would be a revenue neutral change for Pikeville.

³⁸ *Kentucky-American Water Co.*, Case No. 2010-00036 (Ky. PSC. Dec. 14, 2010)(quoting *Ohio Gas Co. v. Pub. Utils. Comm’n of Ohio*, 294 U.S. 63, 73 (1935)).

³⁹ *Kentucky-American Water Co.*, Case No. 97-034 at 23 (Ky. PSC. Sept. 30, 1997).

Respectfully submitted,



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CERTIFICATE OF COMPLIANCE

In accordance with 807 KAR 5:001, Section 8(7), this is to certify that the City of Pikeville's January 13, 2020, electronic filing is a true and accurate copy of the documents being filed in paper medium; that the electronic filing has been transmitted to the Commission on January 13, 2020; that there are currently no parties that the Commission has excused from participation by electronic means in this proceeding; and that an original and a copy of the filing are being delivered to the Commission within two (2) business days.



Counsel for City of Pikeville.