

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF BLUEGRASS)
WATER UTILITY OPERATING COMPANY, LLC) CASE NO. 2020-00290
FOR AN ADJUSTMENT OF RATES AND)
APPROVAL OF CONSTRUCTION)

ATTORNEY GENERAL’S POST-HEARING MEMORANDUM BRIEF

The intervenor, the Attorney General of the Commonwealth of Kentucky, through his Office of Rate Intervention (“Attorney General”), provides the following Post-Hearing Memorandum Brief pursuant to the Commission’s Order of May 20, 2021.

At the outset, Bluegrass Water Utility Operating Company, LLC (“Bluegrass”)¹ should be commended for its work in rehabilitating some of the Commonwealth’s troubled small wastewater treatment systems. Those efforts are laudable. Nonetheless, pursuant to KRS 278.010(1) and just as with all other utilities operating within the Commonwealth, Bluegrass is authorized to, “demand, collect and receive fair, just and reasonable rates,” - no more and no less.

I. The Commission must consider the rate-making principles of rate shock and gradualism in deciding whether to approve the rates proposed by Bluegrass.

The Commission has “long-recognized” that rates adjustments which are of a

¹ Bluegrass is a subsidiary of Central States Water Resources, LLC (“CSWR”).

certain magnitude should increase only gradually in order, “to mitigate rate shock.”² In a case involving the *Mountain Water District*, the Commission held that the “Commission’s long-recognized principle of gradualism” was violated where Mountain Water sought an increase of 169% in sewer rates.³ The Commission went on to determine that, “a phased-in approach to a large rate increase is an appropriate way to manage gradualism in an effort to lessen rate shock.”⁴

Here, the proposed percentage increase in rates by system is:⁵

Airview Estates -	130.8%
Brocklyn Subdivision -	138.7%
Fox Run Estates -	70.9%
Great Oaks Subdivision -	231.0%
Golden Acres Subdivision -	141.3%
Kingswood Subdivision -	145.8%
Lake Columbia Estates -	89.7%
Longview and Homsetead Subdivisions -	218.2%
Persimmon Ridge Subdivision -	172.8%
City of River Bluff -	64.1%
Timberland Subdivision -	175.0%
Arcadia Pines Subdivision -	281.9%

² Case No. 2014-00342, *In the Matter of: Application of Mountain Water District for an Adjustment of Water and Sewer Rates*, Order of October 9, 2015.

³ Id.

⁴ Id.

⁵ See BYupdate-ScheduleN-RateComparison.xlsx filed by Bluegrass on March 19, 2021.

Carriage Park Subdivision -	496.7%
Marshall Ridge Subdivision -	536.4%
Randview Subdivision -	281.9%
Center Ridge -	375.1%

Over half of the systems at issue here are seeking a rate increase greater than the shocking 169% increase proposed and subsequently rejected in *Mountain Water District*. Therefore, to the extent rate increases are approved, those rate increases should be phased-in, or other methods utilized to insure that the customers of those systems do not experience rate shock.

II. The Commission should closely scrutinize the projects detailed by Bluegrass to determine whether those projects are calculated at maintaining cost-efficient, basic service for the customers.

The Commission should ensure that all construction projects undertaken by Bluegrass are in furtherance of maintaining only basic functionality of each system. The Commission should review the proposals to ensure that wasteful “gold-plating” of the systems does not occur.

a. Mission Alarm and Remote Monitoring

Bluegrass proposes to recover costs for mission alarms installed at most systems costing from \$7,500 (Longview/Homestead) to \$40,000 (Persimmon Ridge) per system.⁶ The total estimated cost for all mission alarm installation and remote monitoring proposed in the application is \$296,500.⁷ 807 KAR 5:071(7)(4) requires

⁶ Mission Alarm and Monitoring for Delaplain Disposal would cost an estimated \$50,000.

⁷ This total includes estimated costs for the Delaplain Disposal, Herrington Haven, Springcrest, and Woodland Acres systems.

all mechanical equipment at each sewage system to be inspected daily. In order to comply with this regulation, company contractors will be required to visit each system daily. If contractors will be physically present at each system daily, remote monitoring may constitute unnecessary duplication of service. Such wasteful duplication should be denied.

III. The Commission should carefully scrutinize documentation provided in response to the Attorney General's Post-Hearing Data Request to determine the accuracy of the cost estimates provided in the initial testimony filed by Bluegrass.

The cost estimates underlying Bluegrass's proposed rates are just that – estimates. While it is appropriate to set rates based on estimated costs in some circumstances, many of the construction projects for which costs were estimated are now complete. In fact, some were already complete at the time the application was filed. For those costs, which are currently known and measurable, rates should be based on the actual costs accrued as opposed to estimates. To that end, the Attorney General requested that Bluegrass supply documentation of charges and payments associated with completed projects through a Post-Hearing Data Request filed on May 20, 2021. The Attorney General requests that any difference between actual costs and the estimates provided at the time of filing serve to reduce the proposed rates.

IV. The Commission should ensure that a reasonable amount of Utility Plant in Service is retired during the test period on which rates are based.

As discussed by Company Witness Thies under questioning from Commissioner Chandler at the Hearing, Bluegrass failed to reflect any retirements

to adjust Utility Plant in Service for the Forecasted Test Year.⁸ In fact, Bluegrass altogether failed to study whether any such retirements were appropriate.⁹ Such an incomplete analysis inflates the revenue requirement to the detriment of the ratepayer.

V. The Commission should refrain from awarding the return on equity proposed by Bluegrass and set a lower rate consistent with market conditions.

Company Witness D'Ascendis recommended a return on equity of 11.8%, a rate much higher than his 9.07% Discounted Cash Flow Model (DCF) or 10.96% Capital Asset Pricing Model (CAPM). His recommendation is premised on a company-specific "business risk adjustment" of 175 basis points.

Company Witness D'Ascendis' testimony in support of the business risk adjustment focuses on two factors: business risk and financial risk. Regarding business risk, D'Ascendis' testimony focuses on the legal and regulatory environment surrounding water and wastewater systems.¹⁰ However, this analysis neglects the fact that the utilities in the DCF and CAPM proxy groups deal with those same risk factors. Because returns associated with those risks are already embedded within the proxy group, no after-the-fact adjustment is necessary. Further, many of the regulatory risks discussed by D'Ascendis in his testimony relate strictly to drinking water as opposed to wastewater. While Bluegrass does operate Center Ridge, a drinking water utility, all of the other systems are wastewater utilities. Thus, many

⁸ Hearing Transcript, 5/19/2021 at 16:39:00, *et seq.*

⁹ *Id.* at 16:47:00, *et seq.*

¹⁰ App. Exh. 8-E, Testimony of D'Ascendis at 16.

of the factors cited in support of a business risk adjustment simply do not apply to this case.

Company Witness D'Ascendis went on to argue that the small size of Bluegrass also justifies a business risk adjustment.¹¹ The impact of the size of the utility in setting an appropriate return on equity should be tempered because ratepayers have no control over whether the system near their home is bought by a small or large operator. Bluegrass controls the size and diversity of its operations. The Commission should consider that, while Bluegrass may be small, its parent company is larger and controls a more diversified portfolio of utilities. If utility's size impacts business risk, the Commission should consider the true scope of the company's operations, not simply the capitalization of the relatively new venture in the Commonwealth. CSWR has made a business judgment to silo its few Kentucky assets and segregate those from its other operations through the organization of its business. To penalize a ratepayer for that business judgment is unfair, unjust, and unreasonable.

The Commission should approve a reasonable, market-based return on equity that does not include the company-specific business risk proposed by Bluegrass.

VI. The Commission should set the cost of debt at a fair and reasonable rate.

Company Witness Nelson testified that Bluegrass is currently negotiating the terms for a loan and expects the rate to be in the range of 9% to 10%. Based on those negotiations, Nelson suggested the Commission approve a cost of debt of 9.5%, the midpoint of that range. The Commission should do as much as is within its control

¹¹ Id. at 46.

to ensure that the cost of debt accurately reflects true market conditions and does not allow Bluegrass's failure to timely secure a loan to operate to the detriment of ratepayers.

Further, Company Witness Nelson indicated in her testimony that the distressed nature of the systems increases the cost of debt.¹² However, Bluegrass has already made substantial progress regarding system improvements, as demonstrated by the video shown at the opening of the Hearing.¹³ It is difficult to reconcile an alleged need for a higher revenue requirement based on the poor condition of the systems when representations have simultaneously been made that the systems at issue already have or soon will be fully rehabilitated.

For those reasons, the Attorney General requests that the Commission set the cost of debt at the lowest reasonable rate.

VII. The application for a rate increase may be premature.

In the alternative, the Commission should only consider the CPCN portion of the application at this time and require Bluegrass to submit an updated rate application at a later date to the extent the Commission is allowed to do so by applicable law.¹⁴ Bluegrass originally indicated that they intended to wait until mid-year 2021 before filing its initial rate case for some of the systems at issue.¹⁵ To do

¹² App. Exh. 8-F, Testimony of Nelson at 10. "While not identical to, or fully reflective of, the risks facing small, distressed water utilities such as Bluegrass Water, B-rated and CCC-rated utility debt yields are the closest proxy I could find to assess the reasonableness of the Company's requested cost of long-term debt."

¹³ Hearing Transcript, 5/18/2021 at 14:02:16, *et seq.*

¹⁴ A postponement of justified rate adjustments may be precluded by KRS 278.190 if the Commission determines that Bluegrass has met its burden.

¹⁵ See discussion at Hearing Transcript, 5/19/2021 at 09:52:17 *et seq.*

so would be logical, as it would allow the utility to: (1) collect a full year of actual data, (2) determine if connecting to local municipal systems is a viable option, and (3) obtain actual completed costs. Most importantly, it would allow for consideration of rates for all of Bluegrass systems, including the four denied inclusion in this case.¹⁶ Bluegrass' unique business model addresses important wastewater needs for some small systems in the Commonwealth. It is important that the Commission consider the full scope of Bluegrass' operations before setting rates.

VIII. Conclusion

For the foregoing reasons, the Attorney General requests that the rate increases proposed by Bluegrass be denied, and to the extent a rate increase is granted, such a rate increase be phased in gradually to minimize rate shock experienced by ratepayers.

¹⁶ See Order of February 12, 2012 in Case No. 2020-00290 which excluded the systems at issue in Case No. 2020-00297 (Delaplain Disposal Company, Herrington Haven Wastewater Company, Inc., Springcrest Sewer Company, Inc., and Woodland Acres Utilities, LLC) from rate-making consideration in this case.

Respectfully submitted,

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Certificate of Service and Filing

Pursuant to the Commission's Orders dated March 16, 2020 and March 24, 2020 in Case No. 2020-00085, and in accord with all other applicable law, Counsel certifies that, on June 3rd, 2021, an electronic copy of the forgoing was served by e-mail to the following. A physical copy of the filing will be submitted to the Commission once the State of Emergency has ceased.

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