

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF BLUEGRASS )  
WATER UTILITY OPERATING COMPANY, LLC )  
FOR AN ADJUSTMENT OF SEWAGE RATES )

CASE NO.  
2022-000432

**MEMORANDUM BRIEF**

Respectfully submitted,

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### **Notice And Certification For Filing**

Undersigned counsel provides notice that the electronic version of the paper has been submitted to the Commission by uploading it using the Commission's E-Filing System on this 27<sup>th</sup> day of October, 2023, in conformity with the Commission's April 14, 2023 Order of procedure in the instant case. Pursuant to the Commission's Orders in Case No. 2020-00085, *Electronic Emergency Docket Related to Novel Coronavirus Covid-19*, the paper, in paper medium, is not required to be filed.

/s/ David E. Spenard

### **Notice And Certification Concerning Service**

No party has been excused from the electronic filing procedures in the instant proceeding.

/s/ David E. Spenard

## SECTION 1. INTRODUCTION

On February 27, 2023, Bluegrass Water Utility Operating Company, LLC (“Bluegrass Water” or “Company”), tendered the *Application* in the instant case that proposes an adjustment of its sewage rates.<sup>1</sup> On April 14, 2023, the Kentucky Public Service Commission (“Commission” or “PSC”) entered an Order that, among other things, deemed the *Application* filed as of that date, suspended the proposed rates for five (5) months up to and including October 13, 2023, and established a procedural schedule for the Commission’s review of the rate adjustment request.<sup>2</sup>

The Kentucky Office of the Attorney General (“KY OAG” or “OAG”) was, upon motion, granted intervention into the proceeding by an Order entered on January 10, 2023.<sup>3</sup> Scott County, Kentucky, through its County Judge/Executive and the Fiscal Court (“Scott County”) was, upon motion, granted intervention into the proceeding by an Order entered on May 5, 2023.<sup>4</sup> Bluegrass Water, the OAG, and Scott County are the only parties to the instant case.

The evidentiary record includes the *Application* (containing written testimony, financial exhibits, and other document and as supplemented by updates and revisions), written testimony submitted by a witness for the OAG, written testimony by a witness for Scott County, numerous responses by Bluegrass Water and the parties to requests for information (including post-hearing requests for information), and the transcript of

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<sup>1</sup> Application (tendered Feb. 27, 2023).

<sup>2</sup> Order (Ky. P.S.C. Apr. 14, 2023).

<sup>3</sup> Order (Ky. P.S.C. Jan. 10, 2023).

<sup>4</sup> Order (Ky. P.S.C. May 5, 2023).

evidence for an evidentiary hearing which was held on September 19 and 20, 2023. The case record for the proceeding also includes numerous public comments submitted to the Commission.

Pursuant to the Commission's Order concerning procedures for post-hearing briefing,<sup>5</sup> Scott County submits its *Memorandum Brief* in support of its positions. The presentation of each discussion is set forth in the following order.

**SECTION 2. BLUEGRASS WATER IMPROPERLY INCREASED THE COMPANY'S LAND ACCOUNTS, 310.000 AND 310.100, THROUGH AN APPRAISED VALUE ADJUSTMENT. (PAGES 5 TO 10)**

**SECTION 3. BLUEGRASS WATER FAILS TO SUSTAIN ITS BURDEN OF PROOF FOR RECOVERY THROUGH RATES FOR THE PREMIUM IT RAID TO THE FORMER OWNER OF THE DELAPLAIN DISPOSAL COMPANY FOR THE PURCHASE OF THAT SYSTEM. (PAGES 10 TO 15)**

**SECTION 4. BLUEGRASS WATER FAILS TO SUSTAIN ITS BURDEN OF PROOF FOR INCREASING THE PERCENTAGE OF REVENUE REQUIREMENT APPORTIONED TO CUSTOMERS RECEIVING METERED SEWER SERVICE. (PAGES 15 TO 17)**

**SECTION 5. THE FACTS OF THE INSTANT CASE SUPPORT THE APPLICATION OF THE RATE DESIGN PRINCIPLES OF THE AVOIDANCE OF RATE SHOCK AND GRADUALISM FOR THE ESTABLISHMENT OF A RATE PHASE-IN. (PAGES 17 TO 24)**

Scott County acknowledges that its review and recommendations upon the *Application* are not as extensive as those offered by the OAG. Except as where expressly identified and discussed as differing from (or inconsistent with) the recommendations of Scott County, the recommendations of the OAG are adopted and endorsed by Scott County. Moreover, any lack of discussion of a Bluegrass Water proposal or

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<sup>5</sup> Order (Ky. P.S.C. Sept. 22, 2023).

recommendation should not be construed as an endorsement of Bluegrass Water's position or agreement by Scott County that Bluegrass Water has met its burden of proof.<sup>6</sup>

**SECTION 2. BLUEGRASS WATER IMPROPERLY INCREASED THE COMPANY'S LAND ACCOUNTS, 310.000 AND 310.100, THROUGH AN APPRAISED VALUE ADJUSTMENT.**

807 KAR 5:006, Section 4(6) states: "Record and report retention. All records and reports shall be retained in accordance with the uniform system of accounts unless otherwise specified." The Uniform System of Accounts adopted by the Kentucky Public Service Commission (effective Oct. 1, 1979) ("USoA") states, in pertinent part:

All amounts included in the accounts for utility plant acquired as an operating unit or system, shall be stated at the cost incurred by the person who first devoted the property to utility service and all other utility plant shall be included in the accounts at the cost incurred by the utility except as otherwise provided in the texts of the intangible plant accounts.<sup>7</sup>

When a transfer occurs, the utility plant acquired should be recorded on the books of its acquirer at the original cost.<sup>8</sup> Bluegrass Water was charged with notice of 807 KAR 5:006, Section 4(6) and the Commission's USoA for sewers prior to its execution of an agreement to purchase the former Delaplain Disposal Company (also "Delaplain Disposal"). Bluegrass Water either knew or should have known the Commission's ratemaking treatment of land and land rights purchased from Delaplain Disposal.

The prospective ratemaking treatment of land and land rights was a matter solely between Bluegrass Water and Delaplain Disposal during the negotiations of a purchase

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<sup>6</sup> See KRS 278.190(3).

<sup>7</sup> Utility Plant Instructions, 1(A), USoA, at page 18 (Utility Plant to be Recorded at Cost).

<sup>8</sup> Ariel E. Miller Testimony (filed June 30, 2023), at page 5 ("Miller Testimony").

price. If there were any questions concerning the original cost value of the land, they were questions for Bluegrass Water to resolve prior to the execution of the agreement.

Bluegrass Water obtained an appraisal of the Delaplain Disposal Company.<sup>9</sup> Although the appraisal report states that the intended use is for regulatory filings,<sup>10</sup> the appraisal is hypothetical –

This report is predicated upon the hypothetical condition that the property is vacant land unencumbered by the existing improvements. In other words, this appraisal is of the underlying land as if vacant and ready for development.<sup>11</sup>

The report is not an assessment of the value of the land and land rights of the Delaplain Disposal Company as that property existed (in fact rather than hypothetically) at the time of the report. It does not evidence a review or otherwise contain a discussion of the books and records of Delaplain Disposal, the Commission's USoA, or ratemaking principles and precedent, all of which were readily available at the time that the report was prepared. For reasons that will be expanded upon later in this *Memorandum Brief*, it does not attempt to assess and apportion any contributions in aid of construction held by Delaplain Disposal at the time of the valuation. It is, literally, without value for determining issues in the instant case. By reference to requirements of KRS 278.295 for an Order of the Commission concerning the value of acquired assets (which does not apply in this instance but aids in demonstration), the report fails as reliable evidence of valuation for ratemaking purposes. It is of no usefulness in the instant case.

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<sup>9</sup> Bluegrass Water Response to Commission Staff's Third Request for Information (filed June 16, 2023), Exhibit PSC 3-8 (Appraisals) ("Bluegrass Response PSC 3-8").

<sup>10</sup> *Id.*, page 118 of 327.

<sup>11</sup> *Id.*, page 120 of 327.

If Bluegrass Water had concerns regarding the original cost of the Delaplain Disposal land and land rights and the corresponding ratemaking implications, it was a matter for negotiations in arriving at a purchase price. Bluegrass Water offers no persuasive authority for its decision to increase its land and land rights accounts based upon a hypothetical valuation of the Delaplain Disposal system. Accordingly, the Commission should remove \$629,772.02 from the land and land accounts.<sup>12</sup>

Another troubling aspect of the decision to use the appraised value to write-up the land and land rights of the acquired system is that the former Delaplain Disposal Company had a balance of \$521,066 balance in contributions in aid of construction (“CIAC”) on its books at the time of its acquisition by Bluegrass Water.<sup>13</sup> As Mr. Thies points out in his filed testimony in support of the *Application* in the instant case: “For ratemaking purposes, it [CIAC] is not considered investor supplied capital.”<sup>14</sup> Further: “Bluegrass Water is not permitted to include this amount in rate base and earn a return on it.”<sup>15</sup> CIAC balances are “amortized as an offset to depreciation expense and the net amount of CIAC calculated” is a reduction to rate base.<sup>16</sup>

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<sup>12</sup> Miller Testimony, page 5.

<sup>13</sup> Case No. 2020-00297, Post Case Referenced Correspondence (Mar. 25, 2021), Excel spreadsheet “KYPSC2020-00297\_PurchaseAcctg-Feb23 Acquisitions.xlsx,” Bluegrass Water journal entries for Delaplain, Herrington Haven and Springcrest (“Journal Entries for Delaplain Transfer”) referencing, in pertinent part, 2019 Annual Report of Delaplain Disposal Company, CIAC-Sewer, page 13 of 44.

<sup>14</sup> *Application* (tendered Feb. 27, 2023), Exhibit 10, Testimony of Thies, page 24.

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*, pages 24 and 25.

Bluegrass Water is the party with the burden of proof.<sup>17</sup> It has not offered a demonstration that its treatment of the amount paid in excess of book value for the Delaplain Disposal system prevents an impairment or frustration of ratemaking policy concerning contributions in aid of construction.

Prior to the application in the instant case by Bluegrass Water, the most recent rate adjustment application for the Delaplain service area was Case No. 2010-00349, an application filed by Delaplain Disposal Company's prior owner.<sup>18</sup> The application in Case No. 2020-00349 states that 36 percent of utility plant was recovered through the sale of lots or other contributions.<sup>19</sup>

Bluegrass Water acquired "all assets used or useful to operate the system, including real property interests, service machinery and equipment, other tangible fixtures or personality, franchises, contract rights, accounts receivable, and other intangibles."<sup>20</sup> Therefore, the acquisition included \$521,066 CIAC held by Delaplain, utility property for which the investors had not supplied the capital. The Journal Entries for Delaplain Transfer include a debit amount of \$425,345.50 for Account 272.000, Acc Amort – CIAC-Sewer, noted as "Forward from 2019 Annual Report."<sup>21</sup>

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<sup>17</sup> KRS 278.190(3).

<sup>18</sup> *Alternative Rate Filing Adjustment for Delaplain Disposal Company*, (Application filed Aug. 31, 2010) ("Case No. 2010-00349").

<sup>19</sup> Case No. 20210-00349, Application (filed Aug. 31. 2010), page 4.

<sup>20</sup> Case No. 2020-00297 (Ky. P.S.C. Jan. 14, 2021), page 4 (footnote omitted); see also *Verified Joint Application*, (filed Sep. 16, 2020), Exhibit G (Purchase and Sale Agreement), Article I, Section 1.01 [PDF 58 of 142].

<sup>21</sup> Case No. 2020-00297, Post Case Referenced Correspondence (Mar. 25, 2021), Journal Entries for Delaplain Transfer. Note: The Uniform System of Accounts for Sewer Utilities (effective Oct. 1, 1979) does not contain an Account 272.000 for accumulated



For ratemaking purposes, Bluegrass Water seeks to hold constant the value of gross value of CIAC on the books at the time of its acquisition of the assets of Delaplain while arguing for an increase in the value of the assets on the books at the time of the acquisition, specifically by increasing land and land rights, an account that is not depreciated or amortized. Bluegrass Water's position results in the permanent increase in value of assets placed into rate base while simultaneously holding constant the CIAC assets that are an offset to rate base, an amount that is subject to amortization and which will necessarily decrease. The position, therefore, arbitrarily inflates rate base because it does not recognize (or assign) any alleged increase in value above book value of the assets acquired to the investment in those assets supplied by CIAC.<sup>22</sup>

In simple terms: Bluegrass Water, which paid a purchase price above original cost book value, chose to compensate the former owner of Delaplain for assets that were not attributable to the former owner's investment in the utility - contributed property that was excluded from ratemaking. Any increase in the value of property supported by CIAC resulting from this purchase price should correspond to an increase in the amount CIAC

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amortization of CIAC; there is no Account 272.000 set forth in the 2019 Annual Report for the Delaplain Disposal Company; and the \$425,345.50 balance for accumulated amortization for CIAC sewer is not otherwise listed in the 2019 Annual Report for the Delaplain Disposal Company. The amount appears to be derived through calculating the percent of CIAC in utility plant and multiplying accumulated depreciation by that percentage.

<sup>22</sup> For illustration: If a utility plant, pre-acquisition, had a balance of \$100.00, and \$40.00 of that balance was supported by CIAC (the percentage consistent with Commission Staff's finding in Case No. 2010-00349, (Ky. P.S.C. May 11, 2011), Staff Report, Appendix C, page 13, Table 4), then 40 percent would be excluded from rate base and recovery through rates. Here, the result of Bluegrass Water's proposal may result in increasing the value of rate base while holding constant the value of CIAC. The burden is upon Bluegrass Water to demonstrate that its treatment of CIAC proper through removing the proper amount from rate base. *See, for assignment of burden*, KRS 278.190(3).

that serves to reduce rate base. This is a determination that should be made before any consideration is given to the treatment of the residual amount by application of the *Delta Test*<sup>23</sup> for an acquisition adjustment because this amount corresponds to assets that were not and should never be part of rate base and subject to recovery through rates.

As demonstrated above, even without reference to the treatment of CIAC, the land and land rights accounts should not have been increased based upon a hypothetical valuation. However, the lack of synchronizing the discussion of the hypothetical valuation with a discussion of CIAC adds an additional reason why the write-up was improper (and further demonstrates why the valuation is of no assistance).

**SECTION 3. BLUEGRASS WATER FAILS TO SUSTAIN ITS BURDEN OF PROOF FOR RECOVERY THROUGH RATES FOR THE PREMIUM IT PAID TO THE FORMER OWNER OF THE DELAPLAIN DISPOSAL COMPANY FOR THE PURCHASE OF THAT SYSTEM.**

The Commission addresses ratemaking for an acquisition premium (a purchase price in excess of book value) through application of the *Delta Test*.<sup>24</sup> The *Delta Test* contains five (5) requirements.<sup>25</sup>

- 1) the purchase was an arms-length transaction;
- 2) the initial investment plus the cost of restoring the facilities to required standards will not adversely impact the overall costs and rates of the existing and new customers;
- 3) operational economies can be achieved through the acquisition;
- 4) the purchase price of utility and non-utility property can be clearly identified; and

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<sup>23</sup> See, Case No. 9059, *An Adjustment of the Rates of Delta Natural Gas Company, Inc.*, Order (Ky. P.S.C. Sept 11, 1985) (“*Delta*” and “*Delta Test*”).

<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

- 5) the purchase will result in overall benefits in the financial and service aspects of the utility's operations.

There are, as a practical matter, substantial overlaps in considering these factors. Demonstration of the satisfaction of each factor through credible and substantial evidence (rather than conclusory statements and generalized observations) is required for meeting the burden of proof.<sup>26</sup> "Acquisition adjustments must be approached with caution to ensure that rates are not artificially inflated by excessive sales premiums."<sup>27</sup> Without conceding that Bluegrass Water meets either of the two (2) remaining requirements of the *Delta Test*, the record demonstrates that Bluegrass Water fails, at minimum, to meet the first, second, and fourth criteria listed above.

Bluegrass Water explains: Acquiring troubled systems is part of its business model.<sup>28</sup>

As the Commission is aware, the systems Bluegrass Water acquired are typically poorly managed, with failing infrastructure, and almost all of the owners of those systems did not have the technical, managerial, and financial ability to make capital investments necessary to ensure regulatory compliance and provide safe, efficient, and reliable service to customers.<sup>29</sup>

Bluegrass Water, in discussing negotiating purchases, further explains:

Finally, since many owners are paying themselves to operate the facility, these previous owners will also demand a higher

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<sup>26</sup> See, for background, Case No. 2004-00103, *Adjustment of the Rates of Kentucky-American Water Company*, Order (Ky. P.S.C. Feb. 28, 2005), pages 4 through 10 (finding and concluding that acquisitions of systems with deficiencies failed *Delta Test*).

<sup>27</sup> *Id.*, page 8.

<sup>28</sup> *Application*, Exhibit 2, Direct Testimony of Josiah Cox, pages 4 through 7.

<sup>29</sup> *Id.*, page 7; see also Transcript of Evidence (Sept. 20, 2023), Day 2 at 9:52:10 to 9:52:35.

purchase price to account for the loss of this personal income stream.<sup>30</sup>

Per the record in Case No. 2020-00297, the application for, among other things, approval of the transfer of the Delaplain Disposal Company assets, the allocation methodology for the purchase price allocation of the Delaplain Disposal transaction differed from other contracts.<sup>31</sup> In the transfer case, Bluegrass Water explained:

The purchase and sales agreement for Delaplain contains terms indicating that the purchase price will be allocated because of negotiations specific to this contract, as the seller request the allocation for income tax purposes due to the amount of the purchase price.<sup>32</sup>

Establishment of an arms-length transaction necessarily requires consideration of the bargaining to protect the interest of ratepayers. The evidence concerning the Delaplain Disposal acquisition supports the conclusion that there was an excessive sales premium. To put a very fine point on this matter: the purchase price for the Delaplain Disposal assets is not the product of an arms-length transaction within the scope of the requirements of the *Delta Test*.

The approach to negotiations that includes replacing the personal income stream of an owner of a system in poor condition is unreasonable because it essentially provides a retirement bonus disconnected from the assets required for reasonable service. Structuring the transaction in a manner to accommodate the prior owner's tax concerns (a manner that differs from other transactions) is not demonstrated as arms-length within

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<sup>30</sup> Bluegrass Water Response to Scott County First Request for Information, (May 19, 2023), Item 15, page 1 of 2.

<sup>31</sup> Case No. 2020-00297, Response to Commission Staff's First Request for Information (Nov. 4, 2020), Item 5(a).

<sup>32</sup> *Id.*

the scope of the *Delta Test*. The prior owner compensation as a service provider concerns a relationship between a vendor and the utility. Compensating a utility's vendor's income stream for service *that will no longer be provided by that vendor* is not the responsibility of the ratepayers. The proposed recovery of the purchase price of the premium paid for the assets of the Delaplain Disposal system adds insult to injury because the ratepayers would end up paying the former owner a bonus, a premium for allowing the system to become troubled.

The investment necessary to restore the facilities in the Delaplain service area is substantial.<sup>33</sup> Bluegrass does not demonstrate that “the initial investment plus the cost of restoring the facilities to the required standards will not adversely impact the overall costs and rates of the existing and new customers.” The initial investment for Delaplain Disposal includes the premium of \$629,772, payment above net book value using original costs.<sup>34</sup> The premium, therefore, represents over ten (10) percent of Bluegrass Water's proposed total [stated] original cost rate base of \$6,257,170 in the instant case.<sup>35</sup> The investment and costs of restoration for the Delaplain Disposal assets does adversely impact overall costs and rates of existing and new customers.

Bluegrass Water fails to meet its burden to demonstrate that the premium paid plus the cost of restoration does not exceed “what otherwise could have been incurred by the

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<sup>33</sup> See Bluegrass Water Response to Scott County First Request for Information (May 19, 2023), Item 7 (Discussion of the state of disrepair of the Delaplain Disposal system when acquired).

<sup>34</sup> Miller Direct, pages 4 through 8.

<sup>35</sup> Second Supplemental Responses to Commission Staff's Third Request for Information (filed Sep. 13, 2023), Item 7 (“Bluegrass Water 2<sup>nd</sup> Supplemental to PSC 3-7”).

utility to remedy its operating deficiencies.”<sup>36</sup> There is no credible analysis supporting such findings or conclusions. Bluegrass Water fails to meet the second requirement of the *Delta Test*.

The fourth requirement of the *Delta Test* requires that purchase price of utility and non-utility property can be clearly identified. In this instance, as discussed above, the purchase price for the assets of the Delaplain Disposal Company was determined through a unique structure to allocate the purchase price favorably to the prior owner. Bluegrass Water fails to demonstrate that the structure satisfies the criteria.

Moreover, the decision to write-up its land and land rights accounts based upon an appraisal also demonstrates that the purchase price of utility property is not clearly identified within the meaning of the *Delta Test*. The Company argues one juncture (outside of the *Delta Test* analysis) that the cost of certain utility assets is unknown and must be separately valued through an alternative (and unrecognized for ratemaking) means yet thereafter maintains (for the *Delta Test*) that it clearly identified the purchase price of the same utility property. The only thing that the Company conclusively demonstrates regarding the fourth criteria is that it paid an amount in excess of the original cost of the assets. The demonstration does not satisfy the *Delta Test*.

There is a strong policy argument, upon review of the cases applying the *Delta Test*, that the recovery of an acquisition adjustment serves primarily to provide an incentive for a company to acquire assets that are outside of its business model. The Commission, at the time of the Delaplain Disposal asset transfer, recognized that

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<sup>36</sup> See Case No. 2004-00103, *Adjustment of the Rates of Kentucky-American Water Company*, Order (Ky. P.S.C. Feb. 28, 2005), page 8.

Bluegrass Water purchases distressed systems as part of its normal business.<sup>37</sup> When it executed the agreement to purchase the assets of the former Delaplain Disposal Company, Bluegrass Water was engaging in a transaction (the acquisition of a distressed system) wholly consistent with its business model and, likewise, accepting the risk for which it seeks compensation for that risk through its return on equity.

For the Company's business model, an acquisition adjustment does not incentivize a transaction that the Company would have entered into without the incentive. The policy rationale of the *Delta Test* does support recovery of an acquisition adjustment for Bluegrass Water's acquisition of the Delaplain Disposal assets. Accordingly, for the reasons above, the Commission should deny any rate recovery for any premium above book value paid by Bluegrass Water for the assets of the Delaplain Disposal Company.

**SECTION 4. BLUEGRASS WATER FAILS TO SUSTAIN ITS BURDEN OF PROOF FOR INCREASING THE PERCENTAGE OF REVENUE REQUIREMENT APPORTIONED TO CUSTOMERS RECEIVING METERED SEWER SERVICE.**

Bluegrass Water did not support its *Application* with a traditional cost of service study.<sup>38</sup> Nonetheless; the Company seeks to shift its rate design allocation percentages between unmetered and metered service (with the only customers receiving metered service being commercial customers in the Delaplain service area) from 85.51 percent and 18.49 percent (respectively) to an allocation of 77.28 percent for unmetered service and 22.72 percent for metered service.<sup>39</sup> When asked to provide the evidentiary support

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<sup>37</sup> Case No. 2020-00297 (Ky. P.S.C. Jan. 14, 2021), page 5.

<sup>38</sup> Application, Exhibit 11, Direct Testimony of Timothy S. Lyons (tendered Feb. 27, 2023), page 4 ("Lyons Direct Testimony").

<sup>39</sup> Miller Testimony, pages 9 and 10; Lyons Direct Testimony, page 7.

for the new percentages, the Company states, at pertinent part, “[T]he Company plans to expand its wastewater treatment facilities in Delaplain to meet a growing demand for wastewater treatment services, a significant portion of which is from metered service, commercial and industrial customers”<sup>40</sup>

The proposal is an unsubstantiated and unreasonable shift in allocation percentages that should be denied. It is also important to point out that Bluegrass Water asserts that “a group of only 5 commercial customers accounts for approximately 10% of the Company’s revenue”<sup>41</sup> thereby presenting a “further risk particular to Bluegrass Water.”<sup>42</sup> Hence, Bluegrass Water simultaneously laments risk attributable to a concentration of revenue in the commercial class yet argues for an increase in the apportionment of revenue to be collected from that very same customer group. By reference to Bluegrass Water’s own position concerning risk, the shift works to the detriment of the Company and its customers.

Evidence indicates that Bluegrass Water’s service in the Delaplain service area is the service expected to grow.<sup>43</sup> As confirmed during the hearing; unlike the “all-in” fixed charge for unmetered service (which will not increase or decrease between rate adjustments), the portion of the charge for metered service based upon the usage

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<sup>40</sup> Bluegrass Water Response to Office of the Attorney General First Request for Information (May 12, 2023), Item 65.

<sup>41</sup> Bluegrass Water’s Supplemental Response to Commission Staff’s Second Request for Information, PSC 2-3 (filed Sep. 15, 2023), Item 3, page 6.

<sup>42</sup> *Id.*

<sup>43</sup> *See also Bluegrass Water Response to Commission Staff’s Second Request for Information* (May 12, 2023), Item 24, page 2 of 2; Bluegrass Water Response to OAG 1-65.



component can vary, including increasing as usage increases.<sup>44</sup> Because the commercial service is already expected to grow while the other service areas remain the same, the collection of rate base revenue for metered service in excess of the current 18.49 percent is already expected. There is no need in this instance to reallocate the unmetered and metered rate design allocation percentages.

**SECTION 5. THE FACTS OF THE INSTANT CASE SUPPORT THE APPLICATION OF THE RATE DESIGN PRINCIPLES OF THE AVOIDANCE OF RATE SHOCK AND GRADUALISM FOR THE ESTABLISHMENT OF A RATE PHASE-IN.**

The Kentucky Public Service Commission is required to establish “fair, just and reasonable” rates.<sup>45</sup> In establishing rates, the Commission has plenary authority.<sup>46</sup> Although not expressly stated in statute, the Commission, through its plenary authority, uses ratemaking policy that implements the principles of gradualism (carefully moving toward cost based rates) and the avoidance of rate shock (mitigation of rate increase) as valid and necessary for designing rates.<sup>47</sup>

The rate schedule proposed by Bluegrass Water through its *Application*, if approved, would result in a violation of these principles and, in turn, falls outside the

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<sup>44</sup> See Transcript of Evidence (Sept. 20, 2023), Day 2 at 1:28:00 to 1:30:12.

<sup>45</sup> KRS 278.030(1); see *National-Southwire Aluminum Co. v. Big Rivers Elec. Corp.*, 785 S.W.2d 503, 510 (Ky. App. 1990).

<sup>46</sup> *Kentucky Public Service Commission v. Commonwealth ex rel. Conway*, 324 S.W.2d 373, 383 (Ky. 2010); see also *National-Southwire*.

<sup>47</sup> See, for examples, Case No. 2012-00152, *Application of Big Sandy Water District for An Adjustment in Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities*, Order (Ky. P.S.C. Mar. 8, 2013), page 5 (gradualism) (“Case No. 2012-00152, Big Sandy”); Case No. 2014-00342, *Application of Mountain Water District for An Adjustment of Water and Sewer Rates*, Order (Ky. P.S.C. Oct. 9, 2015), pages 32 and 33 (gradualism and rate shock) (“Case No. 2014-00342, Mountain Water District”).

boundary of fair, just, and reasonable rates. Therefore, the Commission should establish a one-year phase-in period through which the full effect of the rate increase is deferred for customers who would otherwise be subject to an inordinately high increase in rates. Rather than adding the deferral to rate base, the financing cost of the deferral should be treated as an income statement item (only) with the total cost amortized through a surcharge over a five-year period.

The distribution of the proposed increase in base rate revenue requirement aids in demonstrating both rate shock and the need for gradualism. Bluegrass Water's rate design is provided in the *Application* through the testimony Timothy S. Lyons.<sup>48</sup> In addition to his direct testimony, Bluegrass Water tendered an Excel file containing Mr. Lyon's workpapers for his cost-of-service analysis.<sup>49</sup> Per the *Application*, the total revenue requirement for Bluegrass Water's sewer operations is \$3,727,085.<sup>50</sup>

The Lyons Workpapers tab labeled "Sewer Rate Design" includes information demonstrating the impact of the proposed rate increase on the bills of Bluegrass Water's sewer customers.<sup>51</sup> Although the total revenue requirement is \$3,727,085, the workpapers demonstrate that the total base rate revenue requirement (total revenue requirement minus "Other Revenues" of \$14,462) is \$3,712,623.<sup>52</sup> The analysis of the

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<sup>48</sup> *Application* (tendered Feb. 27, 2023), Exhibit 11, Direct Testimony of Timothy S. Lyons ("Lyons Direct Testimony").

<sup>49</sup> *Application* (tendered Feb. 27, 2023), Exhibit 11, Lyons Workpapers – Cost of Service Analysis ("Lyons Workpapers").

<sup>50</sup> Lyons Workpapers, tab "Revenue Requirements".

<sup>51</sup> Lyons Workpapers, tab "Sewer Rate Design"; *set forth as* "Bill Impact Analysis" in Lyons Direct Testimony, Exhibit 4, Direct Schedule TSL-4.

<sup>52</sup> *Id.*; *see, specifically*, Row 8, Column C and Row 38 Column I.

impact of the proposed increase in base rate revenue on bills of the sewer customers of the various service areas demonstrates that the *Application* proposed a 15.6 percent increase for most of its customers.<sup>53</sup> However, a 90.6 percent increase was proposed for the Delaplain commercial customers and a 695.0 percent increase was proposed for the Delaplain residential customers.<sup>54</sup>

Bluegrass Water provided an updated revenue requirement (subsequent to Scott County filing its testimony) through the Rebuttal Testimony of Brent Thies which states a reduction in the total revenue requirement from \$3,727,085 to \$3,460,559.<sup>55</sup> Bluegrass Water further provided an update to a summary of the sewer revenue requirement.<sup>56</sup> The revised total revenue requirement is stated as decreasing from \$3,727,085 to \$3,449,254.<sup>57</sup> Subtracting out the “Other Revenue” amount of \$14,462, the base rate revenue requirement per this information filed by Bluegrass Water, therefore, is \$3,434,792.

Inserting a revised base rate revenue requirement amount of \$3,434,792 into the Sewer Rate Design tab of the Lyons Workpapers, for purposes of demonstration, produces a revised bill impact analysis of the decrease in Bluegrass Water’s proposal.<sup>58</sup>

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<sup>53</sup> *Id.*

<sup>54</sup> *Id.*

<sup>55</sup> Rebuttal Testimony of Brent Thies (“Thies Rebuttal”) (filed Aug. 11, 2023), pages 2 to 4.

<sup>56</sup> Second Supplemental Responses to Commission Staff’s Third Request for Information (filed Sep. 13, 2023), Item 7 (“Bluegrass Water 2<sup>nd</sup> Supplemental to PSC 3-7”).

<sup>57</sup> *Id.*, Supplemental Exhibit PSC 3-7 (filed Sep. 13, 2013).

<sup>58</sup> **Brief Appendix Exhibit A.**

The proposed increase for most sewer customers decreases from 15.6 percent to 6.9 percent – a reduction of over one-half of the initial proposal. Commercial customers in the Delaplain service area still face a proposed increase of 76.4 percent and residential customers in the same service area face a 635.5 percent increase.<sup>59</sup> The burden of the increase in base rate revenue requirement in the instant case is disproportionately upon, among others, customers in the Delaplain service area, particularly the residential customers.

The magnitude of the differential in percentages between most customers and the Delaplain service area customers *increases* with Bluegrass Water’s revised proposal. Rate design mitigation measures are certainly appropriate in a situation in which the relative burdens (as between customer groups) increase as an applicant decreases its overall request for additional revenues.

Comparatively, in terms of Commission precedent, in Case No. 2014-00342, Mountain Water District, the Commission found a proposed “increase of 169 percent to the sewer division customers will result in rate shock and violates the Commission’s long-recognized principle of gradualism.”<sup>60</sup> In Case No. 2012-00152, Big Sandy, the Commission found that “the principles of rate gradualism violated when a water utility increases its wholesale rate 34.38 percent but increases its retail rates only 6.47.”<sup>61</sup> The policy considerations of gradualism and avoidance of rate shock are demonstrated, by

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<sup>59</sup> *Id.*

<sup>60</sup> Case No. 2014-00342, Order (Ky. P.S.C. Oct. 9, 2015), page 32.

<sup>61</sup> Case No. 2012-00152, Order (Ky. P.S.C. Mar. 8, 2013), page 1.

reference to these precedents, as applicable in the instant case for the process of determining fair, just, and reasonable rates for the retail and commercial customers of Bluegrass Water receiving service in the Delaplain service area.

Scott County recommends a phased-in approach (interim rates for the Delaplain service area for the first twelve (12) months with rates fully phased-in after the interim period) to mitigate against rate shock and promote gradualism. Scott County is aware of Bluegrass Water's objective of establishing a unified rate for service for its operations in Kentucky. The Commission expressly addressed this objective while approving the transfer of control for the assets of Delaplain Disposal to Bluegrass Water.

Bluegrass Water indicated in its application that it ultimately intended to propose a unified rate for all of its systems. The Commission will consider any rate properly proposed pursuant to KRS Chapter 278 and 807 KAR Chapter 5. However, the Commission's approval of the transfers at issue in this case should not be construed as an approval of Bluegrass Water's plan to adopt a unified rate. Rather, the Commission will address any proposed rate change for the systems at issue in this matter when proposed pursuant to KRS Chapter 278 and 807 KAR Chapter 5.<sup>62</sup>

Scott County is aware of the Commission's discussion concerning a unified rate for Bluegrass Water contained in the final Order for its most recent application for a rate adjustment.<sup>63</sup> Scott County, though, is not proposing the maintenance of an indefinite rate

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<sup>62</sup> Case No. 2020-00297, *Electronic Proposed Acquisition by Bluegrass Water Utility Operating Company, LLC and the Transfer of Ownership and Control of Assets By: Delaplain Disposal Company; Herrington Haven Wastewater Company, Inc.; Springcrest Sewer Company, Inc.; and Woodland Acres Utilities, LLC*, Order (Ky. P.S.C. Jan. 14, 2023), page 14.

<sup>63</sup> Case No. 2020-00290, *Electronic Application of Bluegrass Water Utility Operating Company, LLC for An Adjustment of Rates and Approval of Construction*, Order, (Ky. P.S.C. Aug. 2, 2021), pages 13 and 113.

differential between similar customer groups in different service areas; instead, Scott County seeks an interim or rate step for twelve (12) months on the path to unified rates. The proposal is consistent with Commission precedent for the Delaplain service area, unified rates, avoidance of rate shock, and gradualism. Finally, Bluegrass Water does not offer an objection to a phase-in rate *per se*.<sup>64</sup>

Bluegrass Water argues that it should be allowed to have some rate relief associated with the fact that it will forego the collection of the entire revenue requirement while the phase-in rate is in effect.<sup>65</sup> Under the assumption that Bluegrass Water demonstrates that it is entitled to an increase in its rate base revenue requirement, the uncollected revenue from the phase-in could be recovered, upon the completion of the phase-in period, through a surcharge that amortizes the uncollected or deferred revenue (in a mechanism that recognizes the opportunity to recover the corresponding carrying costs).

Any surcharge that amortizes uncollected revenue from a phase-in should be recovered from all Bluegrass Water sewer customers. First, Scott County has the largest customer base, and evidence indicates that growth in the customer base is expected in Scott County.<sup>66</sup> Thus, the remaining sewer customers of Bluegrass Water are already benefiting from the size of the customer base in Scott County much more so than Scott County stands to benefit over time, if at all, from any other current customer bases. Again,

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<sup>64</sup> Bluegrass Water Response to Scott County First Request for Information (May 19, 2023), Item 3 (“Bluegrass Water willing to consider a phase-in approach”).

<sup>65</sup> *Id.*, referencing Bluegrass Water Response to Commission Staff’s Second Request for Information (May 12, 2023), Item 23.

<sup>66</sup> See Bluegrass Water Responses to PSC 2-24 and OAG 1-65.

the Scott County customer base is the one containing the expected growth which will provide even greater benefit to customers in other service areas.

Second, Scott County has demonstrated, through active advocacy, reasons specific to the Delaplain Disposal transfer warranting a reduction in Bluegrass Water's rate base revenue requirement. Scott County does not propose keeping the benefit of this reduction for customers within Scott County. Rather, the reduction in rate base revenue requirement will benefit all the Company's sewer customers. Thus, in terms of symmetry, if other customers benefit from adjustments unique to Bluegrass Water's service area within Scott County, it is not unfair, unjust, or unreasonable for the possible burden of a phase-in to be shared throughout the entire customer base.

In preparing this *Memorandum Brief*, Scott County identified a computational error in Exhibit AEM-3.<sup>67</sup> Under the Phase-In approach, the first step results in \$261,678 of unrecovered/deferred revenue.<sup>68</sup> This amount of unrecovered/deferred revenue includes an adjustment resulting from the application of a gross revenue conversion factor and a gross income conversion factor.<sup>69</sup> There is no need to (separately) apply a gross revenue conversion factor to the unrecovered/deferred revenue amount in arriving at the amount of the additional revenue requirement if the balance is treated as a rate base item. If the balance is treated as an income statement item (only), then the reasonable "all-in" cost

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<sup>67</sup> Scott County Supplemental Responses (filed Aug. 28, 2023), AEM-3, Revised Revenue Requirement and Phase In Rates, [unnumbered] page 5 of 5 ("AEM-3").

<sup>68</sup> AEM-3, [unnumbered page 2 of 5].

<sup>69</sup> AEM-3, Column E, lines 18 through 21 [unnumbered page 1 of 5].

of financing (for the amortization period) is the appropriate amount to add to the amortization of the unrecovered/deferred \$261,678.

#### **SECTION 6. CONCLUSION**

Scott County seeks fair, just, and reasonable rates; Bluegrass Water, likewise, seeks fair, just, and reasonable rates. The ultimate interests of Scott County and Bluegrass Water are not in conflict.

The recommendations by Scott County set forth in this *Memorandum Brief* are based upon the evidence in the instant case, well-established ratemaking rules and principles, and clear Commission precedent. Scott County's recommendations are neither arbitrary nor unreasonable.

Scott County contains the Bluegrass Water service area that is fundamental to Company's financial risk and its growth opportunities. The foregoing recommendations, among other things, assist in properly managing the financial risk of Bluegrass Water and enhancing its growth opportunities.

WHEREFORE, Scott County tenders its *Memorandum Brief* and respectfully requests that the Commission deny the rates proposed through the *Application* and establish new rates consistent with Scott County's recommendations and the additional recommendations of the Attorney General (not in conflict with Scott County), deny and order a correction for Bluegrass Water's improper write-up of its land and land rights accounts, deny Bluegrass Water's request for rate recovery for any premium paid for the assets of the former Delaplain Disposal Company, deny Bluegrass Water's request to apportion an increased amount of revenue requirement to its metered service customers,



order phase-in rates for commercial and residential customers of the Delaplain service area, and all other relief requested in this *Memorandum Brief*.

Memorandum Brief  
Appendix  
Item "A"

| Bluegrass Water Utility Operating Company, LLC<br>Rate Design | Revenue Requirement [1] | Current Revenues | Revenue Increase | Adjusted Bills | Proposed Fixed Charge | Water Usage Variable Charge | Proposed Assignment | Current Assignment |
|---|-------------------------|------------------|------------------|----------------|-----------------------|-----------------------------|---------------------|--------------------|
|---|-------------------------|------------------|------------------|----------------|-----------------------|-----------------------------|---------------------|--------------------|

|                   |                     |                     |              |        |           |            |       |       |
|-------------------|---------------------|---------------------|--------------|--------|-----------|------------|-------|-------|
| Sewer             |                     |                     |              |        |           |            |       |       |
| Unmetered Service | \$ 2,654,407        | \$ 1,973,501        | 34.5%        | 28,872 | \$ 91.94  | 49,776,577 | 77.3% | 81.5% |
| Metered Service   | \$ 780,385          | \$ 447,632          | 74.3%        | 408    | \$ 229.85 | \$ 13,379  | 22.7% | 18.5% |
| <b>Total</b>      | <b>\$ 3,434,792</b> | <b>\$ 2,421,133</b> | <b>41.9%</b> |        |           |            |       |       |

[1] Revenue Requirements excludes other revenues

| Development of Rates          | Bills         | % Bills       | Proposed Fixed Charges | Current Fixed Charges | Usage  | Proposed Usage Charge | Current Usage Charge | Proposed Total Charge | Current Total Charge | Difference        | Difference (%) |
|-------------------------------|---------------|---------------|------------------------|-----------------------|--------|-----------------------|----------------------|-----------------------|----------------------|-------------------|----------------|
| Airview Residential           | 2,373         | 8.0%          | \$ 91.94               | \$ 85.97              | -      | -                     | -                    | \$ 218,193            | \$ 204,024           | \$ 14,168         | 6.9%           |
| Arcadia Pines                 | 310           | 1.0%          | \$ 91.94               | \$ 85.97              | -      | -                     | -                    | \$ 28,500             | \$ 26,650            | \$ 1,851          | 6.9%           |
| Brocklyn Multifamily (2)      | 1,119         | 3.8%          | \$ 68.96               | \$ 64.48              | -      | -                     | -                    | \$ 77,161             | \$ 72,153            | \$ 5,008          | 6.9%           |
| Brocklyn Residential          | 884           | 3.0%          | \$ 91.94               | \$ 85.97              | -      | -                     | -                    | \$ 81,273             | \$ 75,996            | \$ 5,277          | 6.9%           |
| Carriage Park                 | 454           | 1.5%          | \$ 91.94               | \$ 85.97              | -      | -                     | -                    | \$ 41,756             | \$ 39,045            | \$ 2,711          | 6.9%           |
| Darlington Creek              | 1,400         | 4.7%          | \$ 91.94               | \$ 45.00              | -      | -                     | -                    | \$ 128,738            | \$ 63,011            | \$ 65,727         | 104.3%         |
| Delaplain Commercial (1)      | 408           | 1.4%          | \$ 229.85              | -                     | 49,777 | \$ 13.79              | \$ 8.89              | \$ 780,385            | \$ 442,514           | \$ 337,871        | 76.4%          |
| Delaplain                     | 3,654         | 12.4%         | \$ 91.94               | \$ 12.50              | -      | -                     | -                    | \$ 335,970            | \$ 45,678            | \$ 290,292        | 635.5%         |
| Fox Run Residential           | 420           | 1.4%          | \$ 91.94               | \$ 85.97              | -      | -                     | -                    | \$ 38,615             | \$ 36,107            | \$ 2,507          | 6.9%           |
| Golden Acres Residential      | 348           | 1.2%          | \$ 91.94               | \$ 85.97              | -      | -                     | -                    | \$ 31,995             | \$ 29,918            | \$ 2,078          | 6.9%           |
| Great Oaks Residential        | 1,927         | 6.5%          | \$ 91.94               | \$ 85.97              | -      | -                     | -                    | \$ 177,197            | \$ 165,691           | \$ 11,506         | 6.9%           |
| Herrington Haven              | 288           | 1.0%          | \$ 91.94               | \$ 49.66              | -      | -                     | -                    | \$ 26,479             | \$ 14,302            | \$ 12,177         | 85.1%          |
| Kingswood Residential         | 1,570         | 5.3%          | \$ 91.94               | \$ 85.97              | -      | -                     | -                    | \$ 144,386            | \$ 135,010           | \$ 9,375          | 6.9%           |
| Lake Columbia Flat            | 396           | 1.3%          | \$ 91.94               | \$ 85.97              | -      | -                     | -                    | \$ 36,408             | \$ 34,044            | \$ 2,364          | 6.9%           |
| Longview Residential          | 3,960         | 13.4%         | \$ 91.94               | \$ 85.97              | -      | -                     | -                    | \$ 364,098            | \$ 340,456           | \$ 23,642         | 6.9%           |
| Marshall Ridge                | 479           | 1.6%          | \$ 91.94               | \$ 85.97              | -      | -                     | -                    | \$ 43,996             | \$ 41,139            | \$ 2,857          | 6.9%           |
| Persimmon Non-Residential (1) | 12            | 0.0%          | \$ 229.85              | \$ 214.93             | -      | -                     | -                    | \$ 2,758              | \$ 2,579             | \$ 179            | 6.9%           |
| Persimmon Residential         | 4,292         | 14.5%         | \$ 91.94               | \$ 85.97              | -      | -                     | -                    | \$ 394,611            | \$ 368,988           | \$ 25,624         | 6.9%           |
| Randview                      | 661           | 2.2%          | \$ 91.94               | \$ 85.97              | -      | -                     | -                    | \$ 60,760             | \$ 56,814            | \$ 3,945          | 6.9%           |
| River Bluffs                  | 2,164         | 7.3%          | \$ 91.94               | \$ 85.97              | -      | -                     | -                    | \$ 198,976            | \$ 186,056           | \$ 12,920         | 6.9%           |
| Springcrest                   | 504           | 1.7%          | \$ 91.94               | \$ 27.43              | -      | -                     | -                    | \$ 46,338             | \$ 13,825            | \$ 32,513         | 235.2%         |
| Timberland                    | 826           | 2.8%          | \$ 91.94               | \$ 85.97              | -      | -                     | -                    | \$ 75,972             | \$ 71,039            | \$ 4,933          | 6.9%           |
| Woodland Acres                | 1,091         | 3.7%          | \$ 91.94               | \$ 19.47              | -      | -                     | -                    | \$ 100,322            | \$ 21,245            | \$ 79,077         | 372.2%         |
| <b>Total</b>                  | <b>29,542</b> | <b>100.0%</b> |                        |                       |        |                       |                      | <b>\$ 3,434,886</b>   | <b>\$ 2,486,283</b>  | <b>\$ 948,603</b> | <b>38.2%</b>   |

[1] Commercial Fixed Charge reflects 2.50 times the Residential Fixed Charge

[2] Multifamily Fixed Charge reflects 0.75 times the Residential Fixed Charge