

**COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION**

In the Matter of:

**ELECTRONIC APPLICATION OF)
BLUEGRASS WATER UTILITY)
OPERATING COMPANY, LLC FOR AN) Case No. 2022-00432
ADJUSTMENT OF SEWAGE RATES)**

**BLUEGRASS WATER UTILITY OPERATING COMPANY, LLC’S
MOTION FOR PARTIAL REHEARING AND CLARIFICATION
OF THE FEBRUARY 14, 2024 FINAL ORDER**

Bluegrass Water Utility Operating Company, LLC (“Bluegrass Water” or the “Company”), by counsel, and pursuant to KRS 278.400 and 807 KAR 5:001 Section 5, respectfully submits this motion for partial rehearing and clarification of the Final Order entered in this matter on February 14, 2024. Specifically, and as explained more fully below, Bluegrass Water respectfully requests rehearing and clarification of the portion of the Final Order removing acquisition-related legal fees from plant in service and failure to otherwise authorize recovery of such prudently incurred expenses. In support of its motion, Bluegrass Water states as follows.

I. INTRODUCTION

Bluegrass Water prudently incurred reasonable legal fees associated with its acquisition of the 20 wastewater systems at issue in this proceeding. As the Commission recognized, the evidence submitted by Bluegrass Water in this proceeding indicates that the bulk of the legal work for which Bluegrass Water seeks recovery is “related to real estate and regulatory work associated with the purchase[s].”¹ Commission precedent makes clear that recovery of legal expenses related

¹ Final Order, at 29.

to regulatory proceedings and legal work related to real estate used in the provision of utility service is recoverable through rates.²

While the Commission order disagreed with Bluegrass Water’s preliminary placement of the acquisition-related legal fees in Account 183, the Commission’s disagreement should not preclude recovery. Indeed, as is fully shown herein, the Uniform System of Accounts (USoA) for Class A/B Water Utilities, specifically contemplates the inclusion of legal expenses as part of the total utility plant in service (“UPIS”), and further provides that, when purchasing a system, the “cost of acquisition” shall be included in a plant account.³ As a sister state has held, “it is unreasonable to think that legal expenses are not a cost of acquisition.”⁴ The Commission’s disagreement with the accounting mechanisms employed by Bluegrass Water to move the recoverable costs into a UPIS account should not preclude recovery of these otherwise recoverable UPIS investments. Indeed, faced with the choice of awarding Bluegrass Water prudently incurred acquisition-related legal expenses that are authorized by the USoA, or awarding no acquisition-related legal expenses at all, “the Commission cannot simply deny recovery altogether.”⁵

Finally, the failure to authorize recovery of acquisition-related legal expenses could disincentivize future investment from potential acquirers of struggling utilities, thereby frustrating the General Assembly’s stated policy goals of regionalization and consolidation of Kentucky’s fragmented water and wastewater systems.⁶ Legal expenditures are a necessary part of any

² See *In the Matters of: Electronic Application of Kentucky Utilities Company for Adjustment of its Electric Rates, et al.*, Case Nos. 2020-00349, 2020-00350, Order (Dec. 6, 2021).

³ See Uniform System of Accounts for Class A/B Water Companies, at 25, available at https://psc.ky.gov/agencies/psc/forms/uso_a/0600ab02.pdf.

⁴ *Joint Petition of Indiana-American Water Company Inc. and Wastewater Once LLC, et al.*, Cause No. 45461, 2021 Ind. PUC LEXIS 124, at *31 (Ind. PUC June 2, 2021).

⁵ *In re PNM Gas Servs.*, 1 P.3d 383, 408-09 (N.M. 2000).

⁶ See KRS 224A.300(1).

acquisition, and they can frequently be higher when acquiring a small, poorly operated system due to prior owners' lack of procedures and proper recordkeeping. Failure to authorize recovery of any portion of the legal fees associated with an acquisition – which otherwise furthers the goals of regionalization and consolidation – could serve as a disincentive to future investment in Kentucky, a possibility that is intensified by the fact that many states across the country, including states bordering Kentucky, do authorize recovery of such expenses.

Accordingly, Bluegrass Water respectfully requests that the Commission grant rehearing to (1) provide clarification as to the proper accounting treatment of acquisition-related legal fees, which will prove valuable to Bluegrass Water and other utilities seeking to regionalize and consolidate Kentucky's fragmented water system, and (2) authorize recovery of the acquisition-related legal fees as UPIS pursuant to the accounting treatment as clarified by the Commission.

II. STANDARD OF REVIEW

Pursuant to KRS 278.400, “any party to a proceeding may . . . apply for a hearing with respect to any of the matters determined.” Upon hearing of a rate case, the Commission must determine whether proposed rates are “just and reasonable.”⁷ In a rate case, “unreasonable has been construed . . . to be the equivalent of confiscatory.”⁸ “Both state and federal constitutions protect against confiscation of property without regard to the source of acquisition funds.”⁹ The Kentucky Supreme Court has held that the failure to authorize recovery of a properly incurred and recoverable expense is “unreasonable” and “constitutes a taking . . . without just compensation.”¹⁰

⁷ KRS 278.190(3).

⁸ *Pub. Serv. Comm'n v. Dewitt Water Dist.*, 720 S.W.2d 725, 730 (Ky. 1986).

⁹ *Id.* at 730; *see also* Ky. Const. § 2; U.S. Const. amend. XIV.

¹⁰ *Dewitt Water Dist.*, 720 S.W.2d at 730.

III. ARGUMENT

A. **The Commission’s Denial of Recovery for Acquisition-Related Legal Expenses Was Arbitrary, Unreasonable, and Unlawful.**

1. **The Commission Regularly Authorizes Recovery of Similar Legal Expenses.**

The Commission has historically authorized the recovery of prudently incurred legal expenses, including the exact types of legal fees Bluegrass Water seeks to recover in this proceeding. As characterized in the Final Order, the acquisition-related legal fees for which Bluegrass Water seeks recovery include “fees paid to real estate attorneys,” and “legal fees incurred as part of the regulatory process for obtaining approval of acquisitions.”¹¹ Bluegrass Water presented detailed invoices for the acquisition-related legal work performed, which allowed the Commission to review the fees incurred, as well as to verify the nature of the work that was performed.¹² Indeed, the Final Order confirms that “a review of the invoices similarly indicates that the bulk of the work was related to real estate and regulatory work associated with the purchase[s].”¹³

The Commission has routinely authorized recovery of similar legal expenses when reviewing rate proceedings of other utilities. For example, the Commission has previously authorized the recovery of legal expenses based upon evidence that a utility incurred legal expenses for “PSC-related proceedings . . . and expenses for title research and easements.”¹⁴

¹¹ Final Order, at 24 (Feb. 14, 2024).

¹² Bluegrass Water’s Responses to Commission’s Third Requests for Information, No. 3-9, Exhibit PSC 3-9(c).

¹³ Final Order, at 29.

¹⁴ *In the Matter of: Application of Spears Water Company, Inc. for Approval of Construction, Financing, and Adjustment of Rates*, Case No. 98-214, 1999 Ky. PUC LEXIS 108, at *11-12 (Ky. PSC Jan. 28, 1999).

Similarly, the Commission previously granted a Motion for Rehearing and ultimately authorized the recovery of similar legal expenses in rates to customers of LG&E and KU.¹⁵ After initially denying recovery of all forecasted legal expenses through rates, the Commission (on rehearing) authorized KU to recover \$4,260,000 in forecasted legal expenses, LG&E Electric to recover \$960,000 in forecasted legal expenses, and LG&E Gas to recover \$2,880,000 in forecasted legal expenses.¹⁶ A review of Exhibit B to the Motion for Rehearing filed in those cases shows that the legal expenses for which recovery was granted in that proceeding are substantially similar to the legal expenses for which Bluegrass Water seeks recovery here.

For example, KU's forecasted legal expenses included amounts for "regulatory" and "real estate" matters. A further breakdown of those expenses shows that recovery was authorized for legal expenses incurred in regulatory proceedings, similar to the fees Bluegrass Water incurred when obtaining approval of the acquisitions. These fees included the recovery of forecasted legal fees related to environmental cost recovery proceedings, fuel adjustment clause proceedings, regulatory policy issues, integrated resource planning, tariff filings, demand side management filings, and legal fees associated with legislative support.¹⁷

Similarly, the KU fees authorized for recovery as "real estate" matters are virtually indistinguishable from the types of legal fees that Bluegrass Water seeks to recover as acquisition-related legal expenses. The various real estate matters itemized for KU, and for which the forecasted legal expenses were approved, include "Transmission Rights of Way Acquisition,"

¹⁵ See *In the Matters of: Electronic Application of Kentucky Utilities Company for Adjustment of its Electric Rates, et al.*, Case Nos. 2020-00349, 2020-00350, Order (Dec. 6, 2021).

¹⁶ *Id.* at 3.

¹⁷ See Joint Petition of KU and LG&E for Partial Rehearing, Case Nos. 2020-00349, 2020-00350, at Exhibit B-1, 6-9.

“Easements,” and “Real Estate Interest Protection.”¹⁸ Similar forecasted legal expenses were awarded to LG&E.¹⁹

As it is clear that the Commission has routinely authorized recovery of the exact type of legal expenses for which Bluegrass Water seeks recovery, Bluegrass Water should likewise be authorized to recover its acquisition-related legal expenses. Its proof supports this treatment, and as is shown below, the proper method for recovery of these expenses under the USoA governing Class A/B water utilities is to record the acquisition-related legal fees as part of Bluegrass Water’s UPIS.

2. The USoA Adopted by Commission Specifically Contemplates Recovery of Legal Expenses as UPIS.

The Uniform System of Accounts for Class A and B water utilities²⁰ specifically contemplates the inclusion of legal fees in a water utility’s UPIS. Specifically, Paragraph 21 of the Commission’s Accounting Instructions specifically relates to the purchase of utility plant. Paragraph 21(A) provides: “When utility plant constituting an operating unit or system is acquired by purchase, merger, consolidation, liquidation, or otherwise, the costs of acquisition, including expenses incidental thereto properly includible in utility plant, shall be charged to account 104 – Utility Plant Purchased or Sold.”²¹

As the Indiana Utility Regulatory Commission has determined with respect to an affiliate of Kentucky American Water Company, “it is unreasonable to think that legal expenses are not a

¹⁸ *Id.* at Exhibit B-1, 11.

¹⁹ *Id.* at Exhibit B-2, 6-9, 12-13.

²⁰ While only Bluegrass Water’s sewer rates are at issue in this proceeding, Bluegrass Water makes reference to the USoA for water utilities as applied by the Commission in its Final Order. The Commission’s adopted USoA for sewer utilities only applies to Class C/D utilities. *See* <https://psc.ky.gov/agencies/psc/forms/usoa/0900.pdf>.

²¹ *Id.* at 25; *see also id.* at 21, 23 (specifically defining “legal expenditures” as part of overhead construction costs that should be included as UPIS when completing a construction project).

cost of acquisition.”²² Thus, when reviewing the Commission’s Accounting Instructions provided to Class A/B Water Utilities, it is clear that the legal fees incurred by Bluegrass Water are both a “cost of acquisition” and properly includible in a utility plant account.

Furthermore, Paragraph 21(D) of the Accounting Instructions state:

If the property acquired in the purchase of an operating unit or system is in such physical condition when acquired that it is necessary to substantially rehabilitate it in order to bring the property up to the standards of the utility, the cost of such work, except replacements, shall be accounted for as part of the purchase price of the property.²³

Here, it was necessary for Bluegrass Water to rehabilitate each of the systems it purchased to bring the property up to the reasonable standards of Bluegrass Water, including obtaining proper evidence of the property rights necessary to operate the utility. The costs of such rehabilitation, necessarily includes legal expenditures. Indeed, FERC has also explicitly recognized legal expenditures as part of the total costs of a “rehabilitation project.”²⁴ Furthermore, the Commission’s Uniform System of Accounts for Class A/B Water Companies expressly includes “legal expenditures” as an overhead cost within the definition of “construction cost.”²⁵

Accordingly, the acquisition-related legal expenses should have been included in Bluegrass Water’s UPIS.

²² *Joint Petition of Indiana-American Water Company Inc. and Wastewater Once LLC, et al.*, Cause No. 45461, 2021 Ind. PUC LEXIS 124, at *31 (Ind. PUC June 2, 2021).

²³ Uniform System of Accounts for Class A/B Water Companies, at 28, available at <https://psc.ky.gov/agencies/psc/forms/usoa/0600ab02.pdf>.

²⁴ *Sweetwater Hydroelectric*, 54 FERC P62,211, at P63,359, P63,377 (FERC Mar. 28, 1991) (approving a \$600,000 “rehabilitation project” where “Sweetwater [was] proposing no new construction” and the \$600,000 rehabilitation cost included “the cost of legal fees.”).

²⁵ Uniform System of Accounts for Class A/B Water Companies, at 28, available at <https://psc.ky.gov/agencies/psc/forms/usoa/0600ab02.pdf>.

3. It was Arbitrary and Unreasonable for the Commission to Exclude all Acquisition-Related Legal Expenditures.

Having shown that the acquisition-related legal expenditures are recoverable, it was arbitrary and unreasonable for the Commission to deny recovery of the entirety of the acquisition-related legal expenses. In fact, it is evident that the legal expenses incurred by Bluegrass Water were reasonable, and the full amount of legal expenses should be recovered.

While the Commission totaled the acquisition-related legal fees at \$1,117,482, that fails to recognize that those acquisition-related legal fees are associated with the acquisition of all 20 wastewater systems at issue in this proceeding. As a result, the legal fees equate to approximately \$55,874.10 in acquisition-related legal fees per acquired system. When considering the amount of real estate work and regulatory work required to acquire these 20 different systems – largely in part due to the failure of the prior owners to maintain financial records and property rights necessary to properly operate and access the systems – the amount of legal fees incurred is reasonable, as similar work must be done for each of the many systems.

Notwithstanding the fact that acquisition-related legal fees were reasonable, even if the Commission did not believe the full amount of acquisition-related legal fees were “reasonable,” the Commission may not simply disallow recovery of all acquisition-related legal fees. As another state Supreme Court has stated:

[W]e believe that the Commission’s denial of rate case expenses in their entirety was arbitrary and capricious. When confronted with a questionable estimate of rate case expenses on one hand and irrefutable evidence that a utility has prudently incurred substantial, if unquantified, rate case expenses on the other, the Commission cannot simply deny recovery altogether; the Commission instead must determine the amount of reasonable and prudent rate case expenses incurred by the utility. We conclude that it was unreasonable and without support in the record for

the Commission to determine that PNMGS incurred no reasonable rate case expenses in this proceeding.²⁶

The same principle applies here. Denial of the expenses altogether is inconsistent with the Commission's treatment of similar expenses incurred by other utilities. It is also inconsistent with the USoA, which explicitly contemplates recovery of these types of expenses as UPIS. Complete denial, however, would be unreasonable, arbitrary, and unlawful.²⁷

In fact, the Fourth Circuit Court of Appeals has previously found error in an order denying a utility the right to include legal expenses as part of the total cost of its UPIS. In *Appalachian Elec. Power Co. v. Fed. Power Comm'n*, the Federal Power Commission refused to allow an electric utility to include \$524,002.47 in legal expenses on a statement of original cost.²⁸ As the Fourth Circuit framed the issue:

[W]as the company entitled to treat litigation expense incurred in defending its right to develop its property in accordance with its own ideas, and against an asserted servitude, as part of the cost of the property and hence a part of legitimate cost of the project, or must such expense be treated as a loss and as such expense be treated as a loss and as such charged against the earned surplus of the company? We think that the company was clearly entitled to treat it as part of legitimate cost.²⁹

The Fourth Circuit reasoned:

[T]he proper expenses of the litigation should be treated, not as a general loss chargeable against earned surplus, but as an expense incurred in defending and perfecting the title to property necessary to the development of the project. . . . [T]he costs of that litigation were a part of the legitimate costs of bringing that project into being. Any business man would so regard them, any purchaser of the project would so regard them and there is nothing in the statute which requires that they be treated in any other manner. . . . Argument is made that, since legitimate cost under the statute is computed as a basis for rate making or purchase by the public, expenditures made in the course of such litigation as was here involved

²⁶ *In re PNM Gas Servs.*, 1 P.3d 383, 408-09 (N.M. 2000).

²⁷ Even if the Commission disagrees with Bluegrass Water's booking of the expenses to Account 183, rather than Account 104, it should not have simply denied cost recovery; it should have recognized the expenses as recordable in Account 104 and instructed such treatment going forward.

²⁸ *Appalachian Elec. Power Co. v. Fed. Power Comm'n*, 218 F.2d 773, 773 (4th Cir. 1955).

²⁹ *Id.* at 775.

should not be included. If, however, such expenses constitute, as they unquestionably do, a part of the cost of the project to the owners, there is no reason why they should not be included in cost for rate making. . . .³⁰

The acquisition-related legal expenses for which Bluegrass Water seeks recovery are no different than the legal expenses presented to the Fourth Circuit. Indeed, the acquisition-related legal expenses were incurred to perfect title to the property and legitimate costs necessary for the acquisition of this property.³¹ No party has contested that these acquisition-related legal expenses related to those subjects.

Accordingly, the acquisition-related legal expenses incurred by Bluegrass Water are properly recoverable, and they should be included as part of Bluegrass Water's UPIS, as a part of the cost of acquisition of each of the systems acquired. The decision to wholly deny recovery of all of those expenses was unreasonable, arbitrary, and unlawful.

B. Recovery of Prudently Incurred Acquisition Costs Is Consistent with the Commonwealth's Stated Policy Goals.

In addition to the legal justifications compelling recovery of the acquisition-related legal fees sought by Bluegrass Water, recovery of these expenses also furthers the Commonwealth's policy goals. Specifically, KRS 224A.300 provides, in pertinent part:

The General Assembly finds that it is necessary to encourage regionalization, consolidation, and partnerships among governmental agencies, and private parties when appropriate, with the goal of making public water and wastewater treatment secure for all Kentuckians.³²

³⁰ *Id.* at 777, 779.

³¹ See *Joint Petition of Indiana-American Water Company Inc. and Wastewater Once LLC, et al.*, Cause No. 45461, 2021 Ind. PUC LEXIS 124, at *31 (Ind. PUC June 2, 2021) ("It is unreasonable to think that legal expenses are not a cost of acquisition.").

³² KRS 224A.300(1); see also KRS 224A.020 ("The General Assembly of Kentucky finds as fact that the polluting and befouling of the waters of the state has harmed, and is presently harming and injuring, the state's abundant water resources, and, if unabated, will continue to harm such state water resources, and will endanger the health, safety, welfare, and well-being of the general public, and the ability of the state to provide essential governmental services for the benefit of the public, and that such situation, if allowed to continue unchecked, will destroy the natural chemical, physical, and biological integrity of the waters of the state.")

Since purchasing its first systems in Kentucky over four years ago, Bluegrass Water has made significant investment in Kentucky to regionalize and consolidate Kentucky's fragmented wastewater systems (20 of which are included in this proceeding). As has been well-documented in this proceeding, the systems Bluegrass Water purchased had previously fallen into a state of disrepair, almost always with some environmental violation(s).³³ Indeed, Bluegrass Water has provided representative data of its acquired systems' pre-acquisition levels of Carbonaceous Biochemical Oxygen Demand, Ammonia, Total Residual Chlorine, and High Dissolved Oxygen, and representative data of those same levels from August 2023, showing the positive environmental impact Bluegrass Water has brought to the communities it serves.³⁴ A failure to properly maintain compliance with these relevant limitations, which was previously common in almost all the systems purchased by Bluegrass Water, can lead to the destruction of naturally occurring fish and plant life through contamination of Kentucky's natural resources.³⁵ Without a doubt, Bluegrass Water has presented evidence that its actions to date are fulfilling the policy goals of Kentucky's General Assembly because Bluegrass Water has consolidated part of Kentucky's fragmented wastewater system, while preventing and curing injury to the Commonwealth's valuable water resources.

As is unfortunately characteristic of the small utilities that have previously operated the systems that Bluegrass Water has acquired, there has historically been a dearth of appropriate recordkeeping, including account records and land records. As a result, a potential acquirer must ensure that the appropriate legal documentation of property rights can be obtained to safely and

³³ See generally Bluegrass Water's Supplemental Response to PSC 2-3, Exhibit PSC 2-3 (filed Sept. 15, 2023).

³⁴ *Id.* at Page 31.

³⁵ *Id.*

reliably operate and access the utility post-acquisition. Not only does this generally require legal work, it also necessarily requires more significant legal work when the acquired utility has not followed typical recordkeeping practices prior to the acquisition.

Therefore, the Commission’s decision to deny any recovery of the acquisition-related legal fees disincentivizes acquisition of small, troubled utilities, thereby threatening the General Assembly’s stated policy goals. Indeed, acquiring utilities may hesitate to purchase distressed systems if they must absorb the legal costs necessary to effectuate the acquisition. This disincentive, which could threaten the further regionalization of water and wastewater systems across the Commonwealth, is intensified by the fact that other utility commissions around the country, including utility commissions in states bordering Kentucky, authorize some form of recovery of acquisition-related legal fees.³⁶

Accordingly, not only are the acquisition-related legal expenses recoverable under Commission precedent and properly included as UPIS under the USoA applicable to Class A/B water utilities, granting the relief requested in this motion will ensure continued investment in the future of the Commonwealth’s already significant progress in regionalizing and consolidating its water and wastewater systems.

³⁶ See *Application of CSWR-Texas Utility Operating Company, LLC for Authority to Change Rates*, SOAH Docket No. 473-23-18885.WS; PUC Docket No. 54565, Proposal for Decision, at 35-36; 35 n.131 (Texas SOAH Nov. 28, 2023) (approving the inclusion of “acquisition-related expenses” in rate base without objection from any party); *Joint Petition of Indiana-American Water Company Inc. and Wastewater Once LLC, et al.*, Cause No. 45461, 2021 Ind. PUC LEXIS 124, at *28-33 (Ind. PUC June 2, 2021) (authorizing the utility to record in plant accounts the purchase price and costs of acquisition, including legal fees, finding “it is unreasonable to think that legal expenses are not a cost of acquisition”); *In the Matter of Confluence Rivers Utility Operating Company, Inc.’s Request for Authority to Implement a General Rate Increase for Water Service and Sewer Service*, File No. WR-2023-0006, Report and Order, at 33-34 (Mo. PSC Nov. 4, 2023) (authorizing recovery of acquisition-related legal costs over an amortization period); *In re: Expedited Joint Application of Limestone Water Utility Operating Company, LLC and DSH & Associates for Approval of the Acquisition of and to Operate the Wastewater System*, Docket No. 23-000016, 2023 TENN. PUC LEXIS 86, at *22-23 (Tenn. RUC Dec. 26, 2023) (authorizing the acquiring utility to seek to include in rate base in its first rate proceeding following the acquisition, “legal and other transaction-related fees and services”).

WHEREFORE, Bluegrass Water respectfully requests that the Commission grant its Motion for Partial Rehearing and Clarification of the Final Order and order the following relief:

1. Provide clarification as to the proper accounting treatment of acquisition-related legal fees;
2. Authorize recovery of the acquisition-related legal fees as UPIS pursuant to the accounting treatment as clarified by the Commission pursuant to Paragraph 1;
3. Suspend implementation of the rates included in the Final Order pending further Order of the Commission, with all interim rates charged by Bluegrass Water subject to refund pursuant to the obligations contained in the Commission's December 7, 2023 Order;
4. Suspend Bluegrass Water's obligation to file new tariff sheets with the Commission, pending further Order of the Commission;
5. Suspend Bluegrass Water's obligation to issue a refund to each customer, pending further Order of the Commission; and
6. Any and all other relief necessary to accomplish the foregoing.

Respectfully submitted,

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Certification

I hereby certify that a copy of this filing has been served electronically on all parties of record through the use of the Commission's electronic filing system, and there are currently no parties that the Commission has excused from participation by electronic means. Pursuant to the Commission's July 22, 2021 Order in Case No. 2020-00085, a paper copy of this filing has not been transmitted to the Commission.

/s/ Edward T. Depp

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