

**COMMONWEALTH OF KENTUCKY**

**BEFORE THE PUBLIC SERVICE COMMISSION**

**In the Matter of:**

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

**POST-HEARING BRIEF OF  
BLUEGRASS WATER UTILITY OPERATING COMPANY, LLC**

**October 27, 2023**

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**BLUEGRASS WATER’S POST-HEARING BRIEF**

Bluegrass Water Utility Operating Company, LLC (“Bluegrass Water” or the “Company”), by counsel, hereby files its post-hearing brief with the Public Service Commission of Kentucky (“Commission”). As set forth below, the Commission should approve the Company’s application to adjust its wastewater rates because the proposed rates are fair, just and reasonable.

**I. INTRODUCTION**

Since its entry into the Kentucky market, Bluegrass Water has brought, and continues to bring, desperately needed improvements to a host of wastewater systems across the Commonwealth.<sup>1</sup> For the most part, the systems Bluegrass Water acquires have experienced historically-significant degrees of operational and managerial neglect. Unfortunately, as a result, many of the systems have recorded numerous violations of health and environmental regulations, which Bluegrass Water has either successfully brought into compliance or is working diligently to

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<sup>1</sup> By way of background, Bluegrass Water also has water operations in the Commonwealth. Recognizing that this rate case only involves Bluegrass Water’s wastewater operations, this brief and the evidence in this case focused solely on wastewater operations.

bring into compliance. The relief sought in this case is foundational to Bluegrass Water’s ongoing success in this mission.

**A. Background on Bluegrass Water**

For background, Bluegrass Water is the Kentucky-based operating affiliate of Central States Water Resources (“CSWR”), which is the largest owner and operator of individual domestic wastewater systems in the country.<sup>2</sup> Its mission is to bring safe, reliable and environmentally responsible water resources to every community, and in pursuit of that mission, it has already successfully removed a multitude of systems from compliance agreements with state environmental agencies.<sup>3</sup> In fact, CSWR’s operating affiliates around the country have achieved 100% compliance with Agreed Orders (environmental compliance agreements) to bring over 200 wastewater plants into compliance in ten states.<sup>4</sup> Those operating affiliates currently treat approximately 22.4 million gallons per day of wastewater for over 300,000 customers in eleven states. The Company’s investment in water resources serves not only their customers and the environment, however; it also redounds to the benefit of local communities, ultimately enhancing value and driving outside investment and growth.<sup>5</sup>

**B. Bluegrass Water’s Kentucky Plans and Operations**

As a CSWR operating affiliate, Bluegrass Water of course also specializes in using technology and innovation to provide safe, reliable, and environmentally-responsible service to its

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<sup>2</sup> (See Bluegrass Water’s Supplemental Response to PSC 2-3 (filed May 12, 2023); Bluegrass Water’s Exhibit PSC 2-3, at 2 (filed May 12, 2023).)

<sup>3</sup> (See *id.*)

<sup>4</sup> (See *id.* at 5.)

<sup>5</sup> (*Id.* at 4.)

customers in the Commonwealth.<sup>6</sup> Kentucky is certainly not immune to the nationwide infrastructure crisis facing the water and wastewater industries.<sup>7</sup> As the Commission is no doubt aware, small and neglected wastewater facilities have long challenged the Commonwealth.<sup>8</sup> Out

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<sup>6</sup> (See *id.*; see also, e.g., *Electronic Application of Bluegrass Water Utility Operating Company for a Certificate of Public Convenience and Necessity for Projects at the Woodland Acres Site*, Case No. 2022-00015 (available at: <https://psc.ky.gov/Case/ViewCaseFilings/2022-15>) (seeking permission to install an MBBR treatment system, a peracetic acid disinfection system, and a wet weather overflow prevention system); *Electronic Application of Bluegrass Water Utility Operating Company for a Certificate of Public Convenience and Necessity for Projects at the Persimmon Ridge Site*, Case No. 2022-00046 (available at: <https://psc.ky.gov/Case/ViewCaseFilings/2022-46>) (seeking permission to install an MBBR treatment system); *Electronic Application of Bluegrass Water Utility Operating Company for a Certificate of Public Convenience and Necessity for Projects at the Herrington Haven Site*, Case No. 2022-00102 (available at: <https://psc.ky.gov/Case/ViewCaseFilings/2022-102>) (seeking permission to install an MBBR treatment system, a peracetic acid disinfection system, and a solids processing (digester) system); *Electronic Application of Bluegrass Water Utility Operating Company for a Certificate of Public Convenience and Necessity for Projects at the Delaplain Site*, Case No. 2022-00104 (available at: <https://psc.ky.gov/Case/ViewCaseFilings/2022-104>) (seeking permission to install an MBBR treatment system and solids handling improvements); *Electronic Application of Bluegrass Water Utility Operating Company, LLC for Certificate of Public Convenience and Necessity for the Installation of Monitoring Equipment and for a Corresponding Limited Waiver of Daily Inspection Requirements*, Case No. 2022-00216 (available at: <https://psc.ky.gov/Case/ViewCaseFilings/2022-00216>) (seeking permission to install remote monitoring equipment, in addition to other relief).)

<sup>7</sup> Indeed, as is demonstrated by the August 2023 Report from the National Infrastructure Advisory Council, there is a growing water and wastewater crisis across the country, with the National Infrastructure Advisory Council recognizing a purported \$81 billion funding gap for water infrastructure in 2019 alone. See *Preparing United States Critical Infrastructure for Today's Evolving Water Crises*, National Infrastructure Advisory Council, August 2023 at 6-7, available at: [https://www.nacwa.org/docs/default-source/resources---public/niac-water-report.pdf?sfvrsn=f1fac061\\_2](https://www.nacwa.org/docs/default-source/resources---public/niac-water-report.pdf?sfvrsn=f1fac061_2). The National Infrastructure Advisory Council also recognized the benefit that consolidation can bring in the form of “operational efficiencies and economies of scale.” *Id.* at 10.

<sup>8</sup> See generally KRS 224A.300 (finding 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”); see also *Preparing United States Critical Infrastructure for Today's Evolving Water Crises*, National Infrastructure Advisory Council, August 2023, available at: [https://www.nacwa.org/docs/default-source/resources---public/niac-water-report.pdf?sfvrsn=f1fac061\\_2](https://www.nacwa.org/docs/default-source/resources---public/niac-water-report.pdf?sfvrsn=f1fac061_2).

of an estimated 651 NPDES regulated domestic wastewater facilities in Kentucky, 563 of them – that is, 86% of them – have suffered some form of noncompliance in the last three years.<sup>9</sup> These facilities have, over the last five years, incurred an average of 7.1 informal enforcement actions and 1.1 formal enforcement actions.<sup>10</sup>

For the systems it operates, Bluegrass Water has worked closely with the Division of Water and the Energy and Environment Cabinet to form “Friendly Agreed Orders” recognizing noncompliance at wastewater systems and establishing a path to compliance.<sup>11</sup> It has formed these agreements for fifteen historically noncompliant systems; it has brought five facilities into consistent compliance; and it expects to have four more facilities removed from the noncompliant list by the end of 2023.<sup>12</sup> The Company is also currently negotiating a Friendly Agreed Order to rectify environmental issues with the Magruder Village, Moon River, and Yung Farms systems that are the subject of two recent, non-final acquisition cases.<sup>13</sup> In short, Bluegrass Water continues to work closely with environmental regulators in order to help resolve long-term noncompliance

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<sup>9</sup> (*See* Bluegrass Water’s Supplemental Response to PSC 2-3 (filed May 12, 2023); Bluegrass Water’s Exhibit PSC 2-3, at 30 (filed May 12, 2023).)

<sup>10</sup> (*Id.*)

<sup>11</sup> (*Id.*)

<sup>12</sup> (*Id.*)

<sup>13</sup> (*Id.*) The Company notes that it has sought a limited rehearing of the Commission’s September 22, 2023 Order in Case No. 2023-00181 denying a CPCN for the acquisition of the Moon River system located on Lake Barkley. If ultimately denied, the Company will of course not be able to assist with the remediation of the environmental issues at the Moon River marina’s wastewater system.

at systems that often simply do not have the technical, financial, or managerial resources to reinvest in or properly operate the systems on their own.<sup>14</sup>

This history is perhaps best told through photographic evidence. The testimony of Jake Freeman (Director of Engineering for CSWR) and Exhibit PSC 2-3 of the Company’s September 15, 2023, Supplemental Response to PSC 2-3 are replete with photographs showing the often remarkable degree of remediation work that has been necessary at these long-neglected systems, but the following “before and after” examples should help clarify the serious nature of the challenges the Company is steadily solving.<sup>15</sup>

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<sup>14</sup> *(Id.)*

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



Great Oaks:



BEFORE

and



AFTER<sup>16</sup>

Airview:



BEFORE<sup>17</sup>

and



AFTER<sup>18</sup>

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<sup>16</sup> (See Bluegrass Water's Supplemental Response to PSC 2-3 (filed Sept. 15, 2023); Bluegrass Water's Exhibit PSC 2-3, 18 (filed May 12, 2023).)

<sup>17</sup> (Bluegrass Water's Exhibit PSC 2-3, 18 (filed May 12, 2023).)

<sup>18</sup> (Direct Testimony of Jacob Freeman, Application Exhibit 5, 25 (filed Feb. 27, 2023).)

Lake Columbia:



BEFORE

and

AFTER<sup>19</sup>

In recognition of these types of improvements and the benefits of consolidation, the Commission has previously approved the Company consolidating many of its systems into a unified rate across various wastewater systems. At the same time, however, Bluegrass Water's current unified rates, as well as the rates of those systems acquired by the Company that are still

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<sup>19</sup> (See Bluegrass Water's Supplemental Response to PSC 2-3 (filed Sept. 15, 2023); Bluegrass Water's Exhibit PSC 2-3, 18 (filed May 12, 2023).)

charging pre-acquisition rates, no longer suffice to sustain the Company's provision of safe, reliable, and environmentally-responsible services.

The Commission's recent orders approving Bluegrass Water's requests for CPCNs to address the failing infrastructure at recently-purchased systems, as well as the Commission's recognition of the cost saving benefits of technological advancements, recognize the needed investment in Kentucky's water systems. The Commission's approval of Bluegrass Water's proposed rates in this proceeding, including a unified rate to support the consolidation of small systems, will allow Bluegrass Water to recover a fair, just, and reasonable rate so that it may continue to arrest and ameliorate the growing water issues faced by Kentucky's smaller communities.

## II. LEGAL STANDARD

Under KRS 278.030(1), "[e]very utility may demand, collect and receive fair, just and reasonable rates for the services" it renders.<sup>20</sup> Consistent with the statute, the Commission "must ensure that utility rates are fair, just and reasonable to discharge its duty under KRS 278.040 to ensure that utility comply with state law."<sup>21</sup> The Supreme Court of Kentucky has recognized that "fair, just and reasonable is not inconsistent with appropriate classifications that distinguish among customers, service and rates."<sup>22</sup>

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<sup>20</sup> KRS 278.030(1).

<sup>21</sup> *Ky. Pub. Serv. Comm'n v. Commonwealth ex rel. Conway*, 324 S.W.3d 373, 377 (Ky. 2010).

<sup>22</sup> *Pub. Serv. Comm'n of Ky. v. Commonwealth*, 320 S.W.3d 660, 666 (Ky. 2010) (internal quotation marks omitted).

### III. VALUATION

As is fully set forth herein, Bluegrass Water’s proposal will result in rates that are fair, just, and reasonable and will also provide the financial stability enabling Bluegrass Water to provide safe, reliable, and environmentally responsible wastewater service to its Kentucky customers. Each of the following sections discusses, in turn, the various component analyses showing that the Company’s proposed rates are fair, just, and reasonable.

#### A. Historical Test Year with Known and Measurable Adjustments

Utilities may support a rate change application through a “twelve (12) month historical test period that may include adjustments for known and measurable changes; or [a] fully forecasted test period.”<sup>23</sup> When using a historical test year, Commission precedent is clear that the Commission’s regulations do not impose a time limit on proposed known and measurable changes. “807 KAR 5:001, Section 16(1) does not specify a time limitation on a proposed adjustment to a historical test year period, but rather that the adjustment must be based upon known and measurable changes.”<sup>24</sup> Simply put, the Commission’s regulations authorize the utility to utilize either a historical test period or a fully forecasted test period, and there are no restrictions, requirements, or guidelines as to which test period should be used or when.

Here, Bluegrass Water supported its application through a twelve-month historical test year that ended June 30, 2022, with known and measurable adjustments.<sup>25</sup> The use of a historical test year ending June 30, 2022 is a reasonable test year in this proceeding because it “allowed the

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<sup>23</sup> 807 KAR 5:001 Section 16(a)(1) & (2); *see also* 807 KAR 5:071 Section 3(2).

<sup>24</sup> *In the Matter of: Electronic Application of Jackson Purchase Energy Corporation for a General Adjustment of Rates and Other General Relief*, 2022 Ky. PUC LEXIS 329, Case No. 2021-00358, Order at \*7 (Apr. 8, 2022).

<sup>25</sup> (Bluegrass Water’s Application ¶¶ 35, 45-61 (filed Feb. 27, 2023).)

Company to prepare a more complete filing than might have been possible otherwise.”<sup>26</sup> Further, “the Company has not experienced significant operational changes between the end of the test year and the filing date.”<sup>27</sup>

## **B. Depreciation Rates**

In this proceeding, Bluegrass Water proposes to adopt the depreciation rates recommended in the Depreciation Study performed by John Spanos of Gannett Fleming Valuation and Rate Consultants, LLC. The proposed depreciation rates will apply to assets included on the books and records of the Company as of June 30, 2022 and for assets placed in service on or after July 1, 2022.<sup>28</sup>

Mr. Spanos’s Depreciation Study was performed in accordance with industry standards “based on the straight-line method, average service life procedure and remaining life technique.”<sup>29</sup> As was explained by Mr. Spanos, there was very little historical data upon which to conduct his study because “the historical data was not sufficiently tracked by the legacy wastewater systems acquired by the Company.”<sup>30</sup> However, Mr. Spanos conducted field reviews of representative portions of the Bluegrass Water plant in service to “obtain an understanding of the function of the plant and information with respect to the reasons for past retirements and the expected future causes of retirements.”<sup>31</sup> Mr. Spanos further incorporated his past experience working with a number of wastewater utilities to arrive at the recommendations in his Depreciation Study.<sup>32</sup> As

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<sup>26</sup> (Direct Testimony of Brent Thies, Application Exhibit 10, 7:13-14 (filed Feb. 27, 2023).)

<sup>27</sup> (*Id.* at 7:16-17.)

<sup>28</sup> (*Id.* at 21:1-5.)

<sup>29</sup> (Direct Testimony of John Spanos, Application Exhibit 14, 4:2-5(filed Feb. 27, 2023).)

<sup>30</sup> (*Id.* at 6:7-9.)

<sup>31</sup> (*Id.* at 7:17-20.)

<sup>32</sup> (*Id.* at 8:4-9.)

the Commission has recognized, “a depreciation study involves the analysis of a significant amount of information and the preparer’s judgment and experience.”<sup>33</sup>

As part of Mr. Spanos exercising his judgment based on his experience, Mr. Spanos recommended that Bluegrass Water implement a net salvage value to be recovered through its depreciation rates. As Mr. Spanos explained, incorporating net salvage values into depreciation rates most closely aligns the costs of the assets with the ratepayers benefitting from the assets during their useful life because the customers receiving service from the assets will pay the original cost of the asset and the net salvage value (whether negative or positive) through depreciation rates while the asset is in service.<sup>34</sup> In assessing the proposed net salvage values, Mr. Spanos performed an original cost component of the Depreciation Study, which included assessing the value of the current assets. This original cost component was supported by his field study, with a review of the actual plant in service leading Mr. Spanos to believe that a limited amount, if any, of the original plant in service had ever been retired or replaced by the prior owners.<sup>35</sup> Indeed, Mr. Spanos testified that based on his review of the assets, he was confident “the values he had on the books were only plant in service dollars of existing assets and did not include any labor costs that would have been assigned on a capital basis.”<sup>36</sup> As a result, based on Mr. Spanos’s experience and judgment, Mr. Spanos does not believe the Commission’s adoption of the Depreciation Study,

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<sup>33</sup> *In the Matter of: Application of Delta Natural Gas Company, Inc. for an Adjustment of Rates*, 2004 Ky. PUC Lexis 855, Case No. 2004-00067, Order at \*45 (Nov. 10, 2004).

<sup>34</sup> (See Direct Testimony of Spanos, Application Exhibit 14, 9:1-13 (filed Feb. 27, 2023).)

<sup>35</sup> (Sept. 19, 2023 Hearing, John Spanos Hearing Testimony, 1:15-1:17; see also *id.* at 1:18:50-55 (“So there’s no ... any double-dipping, no. It’s not.”).) Please note that the YouTube recording of the hearing video for September 19 does not contain the date and internal time of day. Thus, citations to the September 19 video are for the video time as indicated by YouTube.

<sup>36</sup> (*Id.* at 1:19-1:20.)

including the proposed net salvage values, will provide for recovery of removal or replacement costs that had already been recovered by the prior owners of the systems.<sup>37</sup>

Accordingly, the Commission should adopt the Depreciation Rates set forth in Mr. Spanos's Depreciation Study.

**C. Rate Base**

**i. Rate Base in General**

For the reasons stated herein and based upon the information provided throughout this proceeding, the Commission should approve of the components of rate base as proposed by the Company. As was explained in the Direct Testimony of Brent Thies, the major components of Bluegrass Water's rate base in this proceeding include: utility plant in service, accumulated depreciation, working capital allowance, contributions in aid of construction, and post-test year adjustments.<sup>38</sup>

The utility plant in service is comprised of "the original cost of acquired systems along with acquisition-related expenses and post-acquisition improvements," "construction costs associated with improvements," and asset retirements.<sup>39</sup> Accumulated depreciation is largely carried over from the books of the prior owners and assets placed in service subsequent to acquisition have been depreciated at rates for similar assets of other CSWR regulated entities.<sup>40</sup>

Contributions in aid of construction ("CIAC") primarily consist of customer tap fees, and CIAC

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<sup>37</sup> (*Id.* at 1:18-1:20.)

<sup>38</sup> (Direct Testimony of Thies, Application Exhibit 10, 21:19-23, 22:1-3 (filed Feb. 27, 2023).) While the rate base originally included rate case expense in rate base, the Company has no objection to amortizing rate case expense over three years. (Bluegrass Water's Response to PSC 3-16 (filed Jun. 16, 2023).)

<sup>39</sup> (Direct Testimony of Thies, Application Exhibit 10, 22:5-22 (filed Feb. 27, 2023).)

<sup>40</sup> (*Id.* at 23:3-10.)

will be amortized as an offset to depreciation expense, with the net amount of CIAC utilized as a reduction to rate base.<sup>41</sup>

Bluegrass Water has accounted for working capital allowance by utilizing the 45-day convention, also known as the 1/8 convention. This decision was in large part based upon the Commission's prior rate case Order in which the Commission determined that the 45-day convention was "a reasonable approach for Bluegrass Water, particularly given its size and relative sophistication."<sup>42</sup> The Attorney General's witness, David Dittmore, did not object to the use of the 45-day convention based on the evidence presented in this proceeding, which "indicates that there is indeed a Revenue lag in play associated with the Company's Revenue collection function."<sup>43</sup>

Accordingly, as is further described specifically below, the amounts Bluegrass Water has included in rate base are recoverable and result in fair, just, and reasonable rates.

## **ii. Remote Monitoring Equipment**

At the time Bluegrass Water filed the instant Application, a separate application seeking approval to install remote monitoring equipment and a site visit waiver at the affected systems was pending.<sup>44</sup> In the interim, the Commission denied its application for a CPCN for remote monitoring equipment previously installed but granted Bluegrass Water a waiver from daily

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<sup>41</sup> (*Id.* at 24:20-21, 25:1-5.)

<sup>42</sup> See *In the Matter of Electronic Application of Bluegrass Water Utility Operating Company, LLC for Adjustment of Rates and Approval of Construction*, Case No. 2020-00290, Order at 54 (Aug. 2, 2021).

<sup>43</sup> (Direct Testimony of David Dittmore, 18:9-12 (filed Jun. 30, 2023).)

<sup>44</sup> See *In the Matter of: Electronic Application of Bluegrass Water Utility Operating Company, LLC for a Certificate of Public Convenience and Necessity for the Installation of Monitoring Equipment and for a Corresponding Limited Waiver of Daily Inspection Requirements*, Case No. 2022-00216.



inspection requirements.<sup>45</sup> While denying that CPCN, the Commission expressly held that it would reserve any decision regarding the recovery of remote monitoring costs in this rate case.<sup>46</sup> Specifically, the Commission “f[ound] that any decision regarding the recovery of costs for remote monitoring should be addressed” in this proceeding.<sup>47</sup>

The Commission should authorize the Company to include the costs of the High Tide remote monitoring equipment in rate base and to also recover the ongoing subscription charges related to the remote monitoring equipment because these expenses were prudently incurred, improve operational oversight of these facilities, and – due to the attendant site visit waiver – generate additional operational cost savings. Indeed, the Commission recognized that remote monitoring systems allow for the constant monitoring of equipment to prevent failures and ensure adequate service.<sup>48</sup> Because the remote monitoring equipment allows for constant monitoring of critical equipment, which can prevent damages that an in-person inspection may not immediately detect, the expenses related to remote monitoring can prevent costly capital expenses to repair or replace equipment that would otherwise have been damaged or destroyed in between in-person visits.

Additionally, the Commission’s approval of the site visit waiver brings further cost savings because the remote monitoring system avoids the costs necessary for the daily in-person site visits which have been waived on a limited basis with Commission approval. Indeed, as was explained

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<sup>45</sup> *In the Matter of: Electronic Application of Bluegrass Water Utility Operating Company, LLC for a Certificate of Public Convenience and Necessity for the Installation of Monitoring Equipment and for a Corresponding Limited Waiver of Daily Inspection Requirements*, 2023 Ky. PUC Lexis 538, Case No. 2022-00216, Order at \*7 (Aug. 2, 2023).

<sup>46</sup> *Id.* at \*8.

<sup>47</sup> *Id.*

<sup>48</sup> *Id.* at \*9.

above, when accounting for the site visit waiver and the operational savings achieved from transitioning the remote monitoring services to High Tide from Mission, Bluegrass Water will realize \$196,350.49<sup>49</sup> in operational savings per year.<sup>50</sup> Accordingly, because the expenses related to the High Tide remote monitoring equipment and annual subscription costs for the High Tide service will bring great benefit and cost savings to Bluegrass Water’s ratepayers, the Commission should authorize its recovery in this proceeding.

### **iii. Acquisition-Related Costs**

The Commission should approve Bluegrass Water’s inclusion of acquisition-related costs in the Utility Plant in Service component of its Rate Base. As was set forth in the Direct Testimony of Brent Thies and supported by Bluegrass Water’s CONFIDENTIAL Exhibit BT-13 thereto, the acquisition related costs “include closing costs incurred as part of the purchase process.”<sup>51</sup> The acquisition-related costs for which Bluegrass Water seeks recovery are related to “title charges and recording fees,” “fees paid to real estate attorneys, survey, and mapping professionals and legal fees incurred as part of the regulatory process.”<sup>52</sup>

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<sup>49</sup> See *infra* Part VI.

<sup>50</sup> *In the Matter of: Electronic Application of Bluegrass Water Utility Operating Company, LLC for a Certificate of Public Convenience and Necessity for the Installation of Monitoring Equipment and for a Corresponding Limited Waiver of Daily Inspection Requirements*, 2023 Ky. PUC Lexis 538, Case No. 2022-00216, Order at \*7 (Aug. 2, 2023) (“Assuming that the deviation results in O&M savings, reducing inspections to three days per week will benefit customers by reducing Bluegrass Water’s revenue requirement without a significant impact on service, as the remote monitoring system should meet or exceed the usefulness of the omitted inspection days.”).

<sup>51</sup> (Direct Testimony of Thies, Application Exhibit 10, 23:14-15 (filed Feb. 27, 2023).)

<sup>52</sup> (*Id.* at 23:15-19.)

Generally speaking, a utility may be authorized to include in rate base costs that are incurred for the benefit of the ratepayers.<sup>53</sup> As was explained in Bluegrass Water’s Response to the Commission’s Post-Hearing Data Request 5, these acquisition-related costs serve to benefit the ratepayers of Bluegrass Water because the expenses are largely related to resolving real estate questions regarding ownership of the real property and easements that grant Bluegrass Water the legal ability to provide necessary utility services.<sup>54</sup> Additionally, the acquisition-related costs include the costs of engineering reports and memorandum outlining the capital projects and process improvements necessary to allow Bluegrass Water to provide safe and reliable service and bring plants into compliance with environmental regulations upon transfer of the system.<sup>55</sup>

Clearly then, these costs were incurred for the benefit of ratepayers because environmental violations, systems that are on the verge of a service interruption due to the general state of disrepair, or a lack of real property rights necessary to provide service can all cause disruptions to vital utility service. As a result, the costs, which should have prudently been incurred by the prior owners, were all incurred to serve the ratepayers as the costs incurred allow Bluegrass Water to provide safe, reliable, and environmentally-responsible services upon acquisition.

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<sup>53</sup> See, e.g., *In the Matter of: Application of Kentucky-American Water Company to Increase its Rates*, 1997 Ky. PUC LEXIS 244, Case No. 97-034, Order at \*23-24 (Sept. 30, 1997) (authorizing Kentucky American-Water to recover the costs of a study in rate base where the Commission determined the study benefitted the ratepayers).

<sup>54</sup> (See Bluegrass Water’s Response to PSC PH-5 (filed Oct. 6, 2023) (“[T]hese costs were incurred for title, survey, and other similar costs necessary to acquire knowledge of property ownership and to secure easements and rights of way required to support utility operations, as well as regulatory approval of the same.”).)

<sup>55</sup> (*Id.*)

Furthermore, in seeking to recover these costs, Bluegrass Water has complied with the Uniform System of Accounts that are applicable to Bluegrass Water.<sup>56</sup> Specifically, Bluegrass Water first places these costs in Account 183 as they are incurred, and if the acquisition is approved by the Commission, Bluegrass Water moves the costs from Account 183 in compliance therewith. Account 183 provides, in relevant part: “This account shall be charged with all expenditures for preliminary surveys, plans, investigations, etc., made for the purpose of determining the feasibility of projects under contemplation. If construction results, this account shall be credited and the appropriate utility plant account charged.”<sup>57</sup> As Bluegrass Water explained in response to the Commission Staff’s Post-Hearing Data Requests, “for purpose of applying the NARUC account instructions, [the] ‘project under contemplation’ [(as used in Account 183)] is the acquisition of the system in question and the resulting projects the engineering assessments of the systems reflect are needed to safely and reliably operate the systems purchased.”<sup>58</sup> For any situations where such projects do not result, the acquisition-related costs “were booked to the expense accounts 426 or 930 after the test year.”<sup>59</sup> Accordingly, Bluegrass Water has complied with the Uniform System of Accounts; and consequently, the Commission should authorize recovery of and on the acquisition-related costs as part of utility plant in service.

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<sup>56</sup> <https://psc.ky.gov/agencies/psc/forms/usoa/0700ab02.pdf> .

<sup>57</sup> <https://psc.ky.gov/agencies/psc/forms/usoa/0700ab02.pdf>, at 55 (Account 183).

<sup>58</sup> (Bluegrass Water’s Response to PSC PH-5 (filed Oct. 6, 2023).)

<sup>59</sup> (Bluegrass Water’s Response to PSC PH-12 (filed Oct. 6, 2023); *see also, generally, Electronic Joint Application of Bluegrass Water Utility Operating Company, LLC for Approval of Acquisition and Transfer of Control of Assets of Commonwealth Wastewater Systems, LLC, Yung Farm Estate Homeowner’s Association, Inc., and Moon River Marina and Resort, LLC*, Case No. 2023-00181 (available at: <https://psc.ky.gov/Case/ViewCaseFilings/2023-00181>) (pending rehearing on the limited question of whether to allow acquisition of the Moon River system, which will determine whether Bluegrass Water expenses the corresponding, associated costs or includes them as part of utility plant in service).)

#### **D. Acquisition Adjustments**

For the reasons set forth herein, the Commission should authorize Bluegrass Water to recover the acquisition adjustments requested in this proceeding. As is fully set forth in the Direct Testimony of Brent Thies and as further supported in the record of this proceeding, Bluegrass Water seeks an acquisition adjustment related to the Commission-approved acquisitions of the Airview, Brocklyn, Fox Run, Golden Acres, Great Oaks, Kingswood, Lake Columbia, LH Treatment, Persimmon Ridge, Timberland, Delaplain, River Bluffs, Springcrest, Woodland Acres, and Herrington Haven systems.

##### **i. Application of the Delta Test and KRS 278.295**

As an initial matter, KRS 278.295 does not apply to the ten systems the Company acquired in 2019 and 2020 and for which it seeks a recovery of \$90,171 in acquisition premiums.<sup>60</sup> The effective date of KRS 278.295 was June 29, 2021, and KRS 278.295 does not provide that it has retroactive effect; therefore KRS 278.295 does not apply to those ten systems. Instead, the Delta Test applies to those systems, and Bluegrass Water has addressed each of the Delta Test factors, as more fully described below.<sup>61</sup>

For all remaining systems, even if it were conceded that KRS 278.295 applied to those systems, Bluegrass Water has complied with KRS 278.295 because this is the first rate case to which the remaining Bluegrass Water systems have been subject.<sup>62</sup> Further, because KRS

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<sup>60</sup> (See Bluegrass Water's Response to PSC 4-12(a) (filed Jul. 27, 2023).)

<sup>61</sup> See, e.g., *In the Matter of Electronic Application of Kentucky-American Water Company for an Adjustment of Rates*, 2019 Ky. PUC LEXIS 663, Case No. 2018-00358 Order at \*136-\*37 (discussing development of Delta Test).

<sup>62</sup> See KRS 278.295(4) (“... an acquiring utility may, as part of its first application for a change in base rates following the acquisition of such assets, seek on order declaring the value of the acquired assets for ratemaking purposes.”).

278.295(2)(a)–(e) codifies the factors included in the Delta Test, the Company has complied with its procedures—no matter which test applies to the Company’s requested acquisition adjustment—and the Commission should approve the requested acquisition adjustment.

Specifically, as was explained in the Direct Testimony of Brent Thies, each of the five factors have been established: (1) all acquisitions were negotiated and finalized based upon arms-length negotiations;<sup>63</sup> (2) the impact on rates from the requested adjustment is only 2.7%;<sup>64</sup> (3) the purchase by Bluegrass Water has created numerous benefits and economies of scale which are explained throughout this brief, including the cost savings from operational contractors and additional services provided by Bluegrass Water; (4) Bluegrass Water did not purchase any non-utility property in any acquisition;<sup>65</sup> and (5) Bluegrass Water’s purchase of the systems has resulted in numerous financial and service benefits to the ratepayers, including the addition of new services, as well as the compliance remedies that have added to the ratepayer’s services.

The Commission should approve the requested acquisition adjustment because Bluegrass Water has complied with applicable law, met all factors, and, as the National Regulatory Research Institute has noted, acquisition adjustments provide incentives for consolidation.<sup>66</sup> As the Commission<sup>67</sup> and the National Infrastructure Advisory Council have previously recognized, consolidation can help alleviate the current issues faced by water utilities. Accordingly, the

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<sup>63</sup> (Direct Testimony of Thies, Application Exhibit 10, 33:4-14 (filed Feb. 27, 2023).)

<sup>64</sup> (*Id.* at 33:15-21.)

<sup>65</sup> (*Id.* at 34:11-14.)

<sup>66</sup> (*Id.* at 30:16-21, 31:1-23.)

<sup>67</sup> *See In the Matter of: Electronic Investigation Into Excessive Water Loss by Kentucky’s Jurisdictional Water Utilities*, 2019 Ky. PUC LEXIS 1622, Case No. 2019-00041, Order at Appendix L, at iii (Nov. 22, 2019), (recommending consolidation of small water districts to create a “regional water board” to “reduce duplication of services, achieve economies of scale in purchasing . . .”).

Commission should approve the acquisition adjustment in this proceeding to encourage future regional consolidation to better serve Kentuckians' needs.

**ii. The Commission Should Approve the Acquisition Adjustment Based on Land Appraisals.**

For two systems, Delaplain and River Bluffs, the Company seeks an acquisition adjustment to account for the prior owners' failure to properly account for its property values when maintaining its books and records. The Attorney General's witness, Mr. Dittmore, and Scott County's witness, Ariel Miller, have objected to the use of the land appraisals in requesting the acquisition adjustment. The Commission should not adopt the position of the OAG or Scott County.

First, both Scott County and the OAG fail to appropriately understand that, as an initial matter, Bluegrass Water seeks the acquisition adjustment because the "previous owners often fail to account for land values and easements on their books and records."<sup>68</sup> In several cases, previous owners simply recorded the value of capital improvements, not the value of the underlying land. Thus, through its use of land appraisals, the Company seeks to include the value of the land in the books and records, as it did not appear that the land values, such as newly acquired easements, were ever included in the books and records. Contrary to Mr. Dittmore's claims, to attempt to not overstate the property values, "the land appraisals use prorated values, not the full market value and therefore [the Company is] not attempting to include a market value in rate base."<sup>69</sup> Further, because the surveys appraise easements and owned-property separately, Mr. Dittmore's claim

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<sup>68</sup> (Rebuttal Testimony of Brent Thies, 10:5-6 (filed Aug. 11, 2023).)

<sup>69</sup> (*Id.* at 10:10-12.)

that the property is not essential to utility service is incorrect; easements are essential utility property.<sup>70</sup> Inclusion of the prorated, appraised property values is appropriate.

### **E. Expenses**

Bluegrass Water seeks to recover expenses that were responsibly incurred and has properly excluded expenses that are not recoverable in rates, such as business development expenses and expenses incurred on behalf of affiliated operating entities.

#### **i. Cost Allocation Procedures**

Since the Company's prior rate case, CSWR has adopted a Cost Allocation Manual that changed the cost allocation procedures used to allocate costs to Bluegrass Water.<sup>71</sup> Consistent with the Cost Allocation Manual, and as shown in Bluegrass Water's CONFIDENTIAL Exhibit PSC 3-18, CSWR first excludes all costs that are not recoverable, such as any unrecoverable advertising costs and business development expenses.<sup>72</sup>

Under the Cost Allocation Manual, recoverable costs are then characterized as (1) directly billed charges, (2) jointly billed charges, or (3) indirect charges.<sup>73</sup> Direct billed charges are charges that are directly incurred for the benefit of Bluegrass Water, and – where work is performed directly for Bluegrass Water – includes corporate employee time sheets so that employees may track their time that solely benefits Bluegrass Water.<sup>74</sup> Direct billed changes would also include

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<sup>70</sup> (*See id.* at 10:14-19.)

<sup>71</sup> (*See* Direct Testimony of Thies, Application Exhibit 10, 12:20-21 (filed Feb. 27, 2023); Bluegrass Water's Exhibit PSC 1-1 (filed Apr. 21, 2023).)

<sup>72</sup> (*See also* Bluegrass Water's Response to PSC 3-18 (filed Jun. 16, 2023).)

<sup>73</sup> Bluegrass Water's Exhibit PSC 1-1 (filed Apr. 21, 2023).)

<sup>74</sup> (*See id.* at 7; Direct Testimony of Thies, Application Exhibit 10, 12:4-5 (filed Feb. 27, 2023).)



items such as electric costs that are incurred solely for Bluegrass Water systems.<sup>75</sup> Jointly billed charges are incurred where economies of scale can be achieved by purchasing goods or services in bulk, but the expenses can be allocated based on the benefits provided to each CSWR operating affiliate. For example, economies of scale are achieved through the procurement of a single insurance policy, but – as more fully discussed immediately below – the premiums under the policy are allocated to operating subsidiaries based on the value of insured property.<sup>76</sup> Finally, for indirect charges, the Cost Allocation Manual uses a three-factor methodology to fairly and justly allocate incurred costs that benefit all operating affiliates. The three-factors are: “the average proportion of customer count, operating expenses, and utility plant in service.”<sup>77</sup>

The recoverable expenses allocated to Bluegrass Water, for which Bluegrass Water seeks recovery hereunder, are prudently incurred and result in fair, just and reasonable rates.

**ii. Bluegrass Water’s Insurance Costs Are Reasonable.**

Bluegrass Water’s insurance costs are recoverable and reasonable. Specifically, Bluegrass Water’s Response to PSC PH-7 and Bluegrass Water’s CONFIDENTIAL Exhibit PSC PH-7 provided additional detail on the Company’s insurance expenses. Indeed, OAG’s witness testified at the hearing that he agreed with the Company about its decreased insurance expense.<sup>78</sup> As is

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<sup>75</sup> (See Bluegrass Water’s Exhibit PSC 1-1 at 7 (filed Apr. 21, 2023) (“These costs are procured in the name of the subsidiary and in nearly all cases, the costs are invoiced directly to the subsidiary entity.”).)

<sup>76</sup> (See *id.*)

<sup>77</sup> (*Id.*; see also Bluegrass Water’s Exhibit OAG 1-6 (filed May 26, 2023); Bluegrass Water’s Supplemental Exhibit OAG 1-6 (filed Jul. 6, 2023).)

<sup>78</sup> (Sept. 20, 2023 Hearing, David Dittimore Testimony, 2:15:15–2:16:33; see also Confidential Rebuttal Testimony of Thies, 15:14 (filed Aug. 11, 2023).). Please note that the September 20 video from YouTube includes the time of day. The citations to the September 20 video therefore include the time of day.

reflected in Bluegrass Water’s Response to PSC PH-7, the Company agrees with the gross insurance cost savings set forth by OAG witness, Mr. Dittmore, but the Company added the gross income conversion factor to reflect the ultimate impact the gross cost savings would have on the overall revenue requirement.<sup>79</sup>

Not only are the insurance costs reasonable, they likely result in cost savings to Bluegrass Water’s ratepayers through economies of scale achieved through the issuance of a single policy. As was explained by Mr. Thies, the Company’s insurance agents have advised the Company that it would not be cost advantageous to bid an insurance policy solely for the properties owned by Bluegrass Water.<sup>80</sup> Furthermore, as Mr. Thies explained, the apportionment of insurance premiums based on the property values also results in fair, just, and reasonable rates because for the so-called “Tier 1 Properties” (including CSWR’s Florida systems susceptible to hurricanes), policies are subject to much higher deductibles than for systems in Kentucky and elsewhere.<sup>81</sup>

It is also reasonable for the Company to recover for its Business Interruption Insurance, which is a part of its broader insurance policy.<sup>82</sup> The portions of insurance expenses for Business Interruption Insurance should be recoverable in this proceeding because the payment of such proceeds benefit Bluegrass Water’s customers. For example, when hurricanes struck CSWR’s service areas in Louisiana, it was proceeds from the Business Interruption Insurance that allowed

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<sup>79</sup> (See Bluegrass Water’s Response to OAG PH-1 (filed Oct. 6, 2023).)

<sup>80</sup> (Sept. 20, 2023 Hearing, Brent Thies Hearing Testimony, Confidential Session, 10:00:06-10:00:50 (please note that, although the testimony was given during confidential session, Bluegrass Water does not consider any part of this sentence to be confidential in nature.)

<sup>81</sup> (*Id.* at 11:39:13.)

<sup>82</sup> (See Bluegrass Water’s Response to OAG 2-70 (filed May 26, 2023) (“The policy provided in response to OAG 1-119 covers the ‘Real and Personal Property Including Improvements and Betterments, Business Income, Extra Expense, Property of Others in the Care, Custody or Control of the Insured for which the Insured has legal responsibility to insure’ for CSWR entities.”).)

the operating utility in Louisiana to provide temporary equipment to bring services back up as quickly as possible, while permanent repairs to the systems were ongoing.<sup>83</sup> The same would be true with respect to Kentucky's recent natural disasters, like the Mayfield tornado, which struck near the Company's Western Kentucky systems.<sup>84</sup> Finally, the premiums for Environmental Liability should be recoverable because no portion of those premiums would ever result in insurance coverage for penalties assessed due to non-compliance, as opposed to coverage for environmental clean-up following a natural disaster, for example.<sup>85</sup>

**iii. Bluegrass Water's Wages & Benefits are Reasonable.**

In the previous rate case, the Commission noted that Bluegrass Water had not conducted a wage and benefits study.<sup>86</sup> In an effort to comply with the Commission's criticism regarding the lack of such a study, the Company commissioned a wage and benefits study for this proceeding.<sup>87</sup> Based upon the wages and benefits for eight corporate employees that regularly touch Kentucky operations, the wage and benefits study establishes that while the Company's total compensation is "competitive compared to peers[,] it is "6.2% below the market midpoint."<sup>88</sup>

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<sup>83</sup> (See generally Sept. 20, 2023 Hearing, Thies's Hearing Testimony, at 9:43:20-9:45:30.)

<sup>84</sup> (See *id.*; *cf. id.* at 11:38:40-11:39:34 (questioning by Vice Chair Hatton regarding the "number of natural disasters we've had") (please note that, although the testimony was given during confidential session, Bluegrass Water does not consider any part of this sentence to be confidential in nature).)

<sup>85</sup> (See Sept. 20, 2023 Hearing, Thies's Hearing Testimony, Confidential Session, 9:52:00-9:54:12 (please note that, although the testimony was given during confidential session, Bluegrass Water does not consider any part of this sentence to be confidential in nature).)

<sup>86</sup> See *In the Matter of Electronic Application of Bluegrass Water Utility Operating Company, LLC for Adjustment of Rates and Approval of Construction*, Case No. 2020-00290, Order at 85 (Aug. 2, 2021).

<sup>87</sup> (See Application Exhibit 12, Direct Testimony of Quentin Watkins (filed Feb. 27, 2023).)

<sup>88</sup> (*Id.* at 4:2-3.)

OAG faults that study for not including a Bluegrass executive in the eight positions studied.<sup>89</sup> However, as was explained at the Hearing, those eight positions were selected by Mr. Watkins based upon his understanding that those eight employees have regular job duties and administrative duties specifically relating to Bluegrass Water.<sup>90</sup> Based upon a review of the relevant factors, including geographic location and the availability of qualified individuals, Mr. Watkins determined that the wages and benefits offered to CSWR employees for which Bluegrass Water seeks recovery in this case “are competitive and in line with the benefits offered by other companies in the state and region that compete for the same talent in the marketplace.”<sup>91</sup>

While it is true that Bluegrass Water does have a number of systems clustered in western Kentucky, the bulk of the systems owned by Bluegrass Water are in the “corridor that connects Lexington and Louisville.”<sup>92</sup>

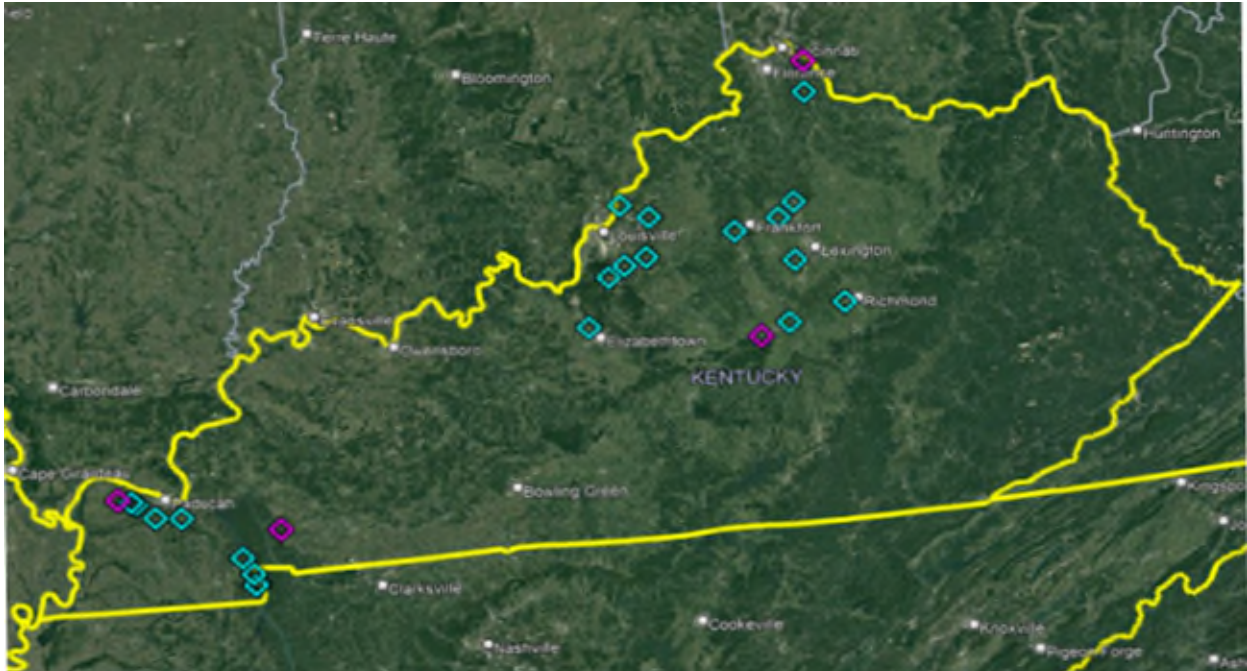
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<sup>89</sup> (See Direct Testimony of Dittmore, 24:2-3 (filed Jun. 30, 2023).)

<sup>90</sup> (Sept. 19, 2023 Hearing, Quentin Watkins’s Hearing Testimony, at 1:53-1:55.)

<sup>91</sup> (Direct Testimony of Watkins, Application Exhibit 12, 4:5-7 (filed Feb. 27, 2023).)

<sup>92</sup> (*Id.* at 4:10-11.)



(Bluegrass Water’s Exhibit PSC 2-3 at 8 (filed May 12, 2023).)

Furthermore, while Lexington and Louisville are within different Federal Reserve Bank Districts, the Federal Reserve Bank of St. Louis’s Cost of Living calculator utilized by Mr. Watkins includes the ability to compare cost of living for various MSAs all across the country.<sup>93</sup> Based upon the cost of living calculator, an individual residing in the St. Louis MSA making \$50,000 per year would have to earn the following salaries to maintain their current standard of living in the following MSAs:

- Lexington, KY: \$49,891
- Louisville, KY: \$49,726
- Elizabethtown, KY: \$46,444
- Evansville, IN: \$48,578

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<sup>93</sup> <https://research.stlouisfed.org/publications/cost-of-living/calculator>

- Cape Girardeau, MO: \$45,077
- Clarksville, TN: \$49,344
- Cincinnati, OH: \$49,234

No matter which MSA close to Bluegrass Water's facilities is used, the salaries are comparable to the St. Louis area. Much like other utilities who have their headquarters in Lexington or Louisville but provide services to customers outside of those cities, when Bluegrass Water achieves the scale to justify hiring its own workforce, it is likely that such an internalized labor force will be located in one of the largest cities surrounding the majority of its facilities. Accordingly, as Mr. Watkins concluded in his testimony, "a review of information from the St. Louis market, where the CSWR employees are located, not only provides an analysis for the purpose of determining whether CSWR's wages and benefits are comparable to those entities with whom it directly competes for high-quality employees in the St. Louis market, but it also provides comparable wage and benefit information for employers in the Kentucky markets where Bluegrass Water predominantly operates."<sup>94</sup>

**iv. Bluegrass Water's Third-Party Contractors Benefit Ratepayers.**

Bluegrass Water seeks to recover expenses related to various contractors Bluegrass Water has retained to assist with the provision of operational and customer support services to its ratepayers. As is set forth throughout the record of this case, the costs for services provided to Bluegrass Water customers through third-party providers are prudently incurred, competitively sourced, benefit Bluegrass Water's ratepayers, and result in cost savings.

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<sup>94</sup> (Direct Testimony of Watkins, Application Exhibit 12, 4:17-20, 5:1-2 (filed Feb. 27, 2023).)

The expenses incurred for Bluegrass Water’s operational contractor, Midwest Water Operations (which was acquired by Clearwater Solutions following the expiration of the test year), best serve Bluegrass Water’s customers because Midwest Water Operations (“Midwest”) is able to provide operational expertise, equipment, and tools at a price Bluegrass Water could not meet by hiring its own employees and purchasing the necessary equipment, tools, and vehicles (which would necessarily include additional insurance expenses). As Mr. Cox testified at the hearing, to meet all compliance requirements, including OSHA requirements, a single employee cannot perform the operational tasks provided by Midwest.<sup>95</sup> As a result, Bluegrass Water could not employ the necessary individuals to perform all required maintenance, buy equipment, and buy necessary tools at a cost that is less than or even equal to the costs charged by its current operator.<sup>96</sup> Instead, at this time, Midwest is able to more economically and efficiently provide the services due to its operations in over 13 states, including the operation of various municipal facilities across the Southeast United States.<sup>97</sup>

Moreover, Bluegrass Water has undertaken efforts to employ a robust RFP process to attempt to find qualified contractors to assist with operations of the Bluegrass Water systems. However, as Mr. Cox testified at the hearing, “it has been very difficult to find and retain qualified operators in Kentucky. There is more effort put into this state than almost any other state in the country.”<sup>98</sup> Mr. Cox further testified that, in an attempt to bid in geographic blocks or award operator contractors by system, he “personally called some operations companies to see if they

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<sup>95</sup> (Sept. 19, 2023 Hearing, Josiah Cox Hearing Testimony, at 4:52.)

<sup>96</sup> (*Id.* at 4:54-4:55.)

<sup>97</sup> See <https://clearwatersol.com/>.

<sup>98</sup> (Sept. 19, 2023 Hearing, Cox Hearing Testimony, at 4:35.)

would bid part of those systems.”<sup>99</sup> Mr. Cox said that the response was a “resounding no.”<sup>100</sup> Mr. Thomas also explained at the hearing that Bluegrass Water’s awarding of contracts to service its systems has directly resulted in Midwest hiring Kentucky citizens to service Bluegrass Water’s systems.<sup>101</sup>

Despite these difficulties, Bluegrass Water’s RFP processes and acquisitions of additional systems have allowed Bluegrass Water to achieve cost savings created by economies of scale. Specifically, Mr. Cox testified that “market pressures have been exerted on [Midwest] to keep the contract prices the same in a highly inflationary market.”<sup>102</sup> Indeed, when the Midwest contract was extended for an additional year in 2023, the prices remained the same.<sup>103</sup> Mr. Cox further estimated that customers had saved “approximately 20%” because Bluegrass Water had refused to accept price increases.<sup>104</sup>

In addition to its operations contractors, due to its increasing size, Bluegrass Water is able to provide additional services to its customers that small utilities typically cannot provide. This includes 24 hour call centers, online bill pay, and in-person payment at various locations in the Bluegrass Water service area.<sup>105</sup> This includes certain customer outreach services provided by Elasticity, which has since been replaced by Ansira, to assist with website hosting, customer messaging, and ensuring that Bluegrass Water’s customers are timely provided notice of severe

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<sup>99</sup> (*Id.* at 4:37.)

<sup>100</sup> (*Id.*)

<sup>101</sup> (Sept. 19, 2023 Hearing, Todd Thomas Hearing Testimony, at 6:26-6:28.)

<sup>102</sup> (Sept. 19, 2023 Hearing, Cox Testimony, at 4:37.)

<sup>103</sup> (*See* Bluegrass Water’s Exhibit PSC 2-19 (filed May 12, 2023).)

<sup>104</sup> (Sept. 19, 2023 Hearing, Cox Testimony, at 4:38.)

<sup>105</sup> (*See* Direct Testimony of Todd Thomas, Application Exhibit 23, 13-17 (filed Feb. 27, 2023).)



weather alerts or boil water advisories.<sup>106</sup> The Company should be authorized to recover expenses related to these services and activities provided because the service expenses are generally recoverable and any assistance with advertising provided by Ansira “produce a material benefit for the ratepayers.”<sup>107</sup>

**v. Bad Debt**

The Commission should approve Bluegrass Water’s proposed bad debt expense, including the proposed known and measurable adjustment equal to 1% of revenue. Attorney General witness David Dittmore has proposed a bad debt expense of \$2,529, which Mr. Dittmore admitted was “relatively low”; however, his recommendation is based upon a flawed understanding of the evidence presented by Bluegrass Water. Specifically, Mr. Dittmore’s claim that Bluegrass Water failed to support its bad debt expenses fails to recognize that the test year expense for bad debt included in data request responses included both water and sewer service, but Bluegrass Water’s pro forma test year expense for bad debt related to sewer *only*.<sup>108</sup> As Mr. Thies further explained, Mr. Dittmore’s proposal should be rejected because it fails to adhere to the general ratemaking principle that those causing the costs should bear them.<sup>109</sup> “Balances written off by Bluegrass Water belong to individuals who have moved out of the address serviced by Bluegrass Water and are no longer customers. Under Mr. Dittmore’s methodology, the remaining customers would incur the entire cost of the former customers’ bad debt.”<sup>110</sup> Accordingly, Bluegrass Water’s

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<sup>106</sup> (See Bluegrass Water’s Response to PSC PH-13 (filed Oct. 6, 2023).)

<sup>107</sup> 807 KAR 5:016 Section 2(1).

<sup>108</sup> (Rebuttal Testimony of Thies, 13:19-21, 14:1-2 (filed Aug. 11, 2023).)

<sup>109</sup> (*Id.* at 14:12-19.)

<sup>110</sup> (*Id.*)

proposed bad debt expense is reasonable and will help alleviate any “mismatch between cost and cost causation.”<sup>111</sup>

**vi. Bluegrass Water Appropriately Excluded Non-Recoverable Expenses, Including Business Development Expenses.**

Bluegrass Water has appropriately excluded non-recoverable expenses, including business development expenses. As Mr. Thies explained in this rebuttal testimony and in CONFIDENTIAL Exhibit PSC 3-18, the process for excluding expenses “start[s] with the total bucket of CSWR expense, remove[s] all employee payroll from the number, remove[s] all executive/business development costs, and remove[s] other line items to exclude.”<sup>112</sup> Moreover, the Company explained that “[i]n addition to removing the cost of salaries associated with business development employees, the Company removed all expense reports provided by Business Development employees and certain vendors whose primary purpose related to the acquisition of new systems rather than ongoing business activities.”<sup>113</sup> Bluegrass Water has provided the general ledger of CSWR showing this process in Bluegrass Water’s CONFIDENTIAL Exhibit PSC 3-18 (filed May 26, 2023). While the Attorney General’s witness, Mr. Dittmore, originally testified that Bluegrass Water had failed to show it had removed Business Development Expenses, this testimony was later deleted through an Errata filing,<sup>114</sup> and Mr. Dittmore acknowledged at the hearing that “in

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<sup>111</sup> (*Id.*)

<sup>112</sup> (Rebuttal Testimony of Thies, 8:9-11 (filed Aug. 11, 2023); *see also* Sept. 20, 2023 Hearing, Thies’s Hearing Testimony, Confidential Session, 10:18:30-10:18:46 (“If we go back to the overhead analysis that we were talking about, and we removed all the payroll costs, then this is the worksheet that is looking at the timesheets to add payroll costs back in, as they are assignable to Bluegrass [Water]...”).)

<sup>113</sup> (Bluegrass Water’s Response to PSC 3-18 (filed May 26, 2023).)

<sup>114</sup> (David Dittmore Errata Filing (filed Sept. 18, 2023).)

fact, the costs claimed as business development have been excluded . . . .”<sup>115</sup> Further, the “Detail” tab of CONFIDENTIAL Exhibit PSC 3-18 further shows that the Company excluded costs related to donations, lobbying activities, or political/promotional advertising.<sup>116</sup>

Finally, in response to post-hearing data requests, Bluegrass Water explained how, in addition to initially backing out payroll expense, it had also excluded corresponding workers’ compensation expenses.<sup>117</sup> In sum, Bluegrass Water appropriately excluded non-recoverable expenses from its proposed revenue requirement in this proceeding.

#### **F. Revenues from Miscellaneous Charges**

The Commission should approve Bluegrass Water’s proposals to implement a late fee and a returned check fee. Indeed, both of these proposals are an attempt to ensure that the Bluegrass Water customers who cause Bluegrass Water to incur additional costs, whether it be through the form of a late payment or inurrence of a returned check fee from Bluegrass Water’s bank, actually bear those costs so that customers who timely pay with sufficient funds do not subsidize those costs.<sup>118</sup>

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<sup>115</sup> (Sept. 20, 2023 Hearing, Dittmore Hearing Testimony, at 14:15:45.)

<sup>116</sup> (Bluegrass Water’s CONFIDENTIAL Exhibit PSC 3-18 (filed May 26, 2023); Direct Testimony of Thies, Application Ex. 10, 18:18-19 (filed Feb. 27, 2023).)

<sup>117</sup> (See Bluegrass Water’s Response to PSC PH-9 (filed Oct. 6, 2023); see also Bluegrass Water’s CONFIDENTIAL Exhibit PSC 3-18 (filed May 26, 2023).)

<sup>118</sup> See *In the Matter of: Electronic Investigation of the Proposed Pole Attachment Tariffs of Rural Electric Cooperative Corporations*, 2022 Ky. PUC LEXIS 1054, Case No. 2022-00106, Order at \*10 (Dec. 28, 2022) (“When determining how a utility’s costs should be allocated among customers, the Commission has long stated that the basic tenant of rate-making is that the costs should be allocated to the cost-causer.”).

**i. Late Fee**

Bluegrass Water’s proposal to add a 10% late payment penalty is reasonable and will properly allocate the costs incurred due to late payment to the customer causing those costs. “Late payments have a cost to the Company. The assessment of late fees is a way to associate revenue and cost with those customers that cause the costs.”<sup>119</sup> In addition, if Bluegrass Water is authorized to recover late fees, the resulting late fee revenue can be included as a portion of the revenue requirement in future rate cases, which can result in lower rates.<sup>120</sup>

**ii. Returned Check Fee**

Bluegrass Water’s proposal to charge a \$15.00 returned check fee will result in fair, just, and reasonable rates. Bluegrass Water has provided evidence that its bank charges Bluegrass Water a \$16.00 fee for each returned check.<sup>121</sup> As a result, approval of Bluegrass Water’s proposed \$15.00 returned check fee will ensure that the Bluegrass Water customer actually causing Bluegrass Water to incur the bank fees will bear the bulk of that cost. This will ensure that the customer causing the costs reimburses Bluegrass Water for the fees that it incurs and other Bluegrass Water customers do not have to pay expenses they did not cause.

**G. Adjustments to the Historical Test Period**

Bluegrass Water has provided a complete description and a quantified explanation of all adjustments made to the historical test-period, and the adjustments should be approved by the

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<sup>119</sup> (Rebuttal Testimony of Thies, 7:7 (filed Aug. 11, 2023); *see also*, *Electronic Joint Application of Bluegrass Water Utility Operating Company, LLC for Approval of Acquisition and Transfer of Ownership and Control of Assets of Commonwealth Wastewater Systems, LLC, Yung Farm Estate Homeowners’ Association, Inc., and Moon River Marina and Resort, LLC*, Case No. 2023-00181, Bluegrass Water’s Exhibit PSC 2-3 Proposed Tariffs (filed Aug. 4, 2023).)

<sup>120</sup> (Rebuttal Testimony of Thies, 7:9-10 (filed Aug. 11, 2023).)

<sup>121</sup> (Bluegrass Water’s Response to OAG 2-8 (filed Jun. 16, 2023).)

Commission.<sup>122</sup> As is set forth on Exhibit BT-3 to the Direct Testimony of Thies, Bluegrass Water made a number of pro forma adjustments to the historical test year to account for its requests in this proceeding, as well as annualization adjustments for certain expenses. These adjustments have been fully documented and explained throughout this case.<sup>123</sup> As was explained in the Direct Testimony of Brent Thies, these adjustments largely relate to adjustments to account for “costs associated with a new customer information system, property taxes, and allocated overhead.”<sup>124</sup> Additionally, because the purchase of the Darlington Creek system closed in March 2022, Bluegrass Water has included a number of annualization adjustments to annualize expenses incurred and revenues received during the test year for the Darlington Creek system.<sup>125</sup>

The Commission should approve a revenue requirement that approves these adjustments because the majority of the adjustments applied by Bluegrass Water were due to cost savings Bluegrass Water has been able to achieve, which benefits ratepayers. As one example, Bluegrass Water’s shift to Muni-Link as its new customer information system resulted in a reduction of \$10,555 from the test year expense.<sup>126</sup> In addition, the Company’s proposed adjustment to overhead expenses resulted in a reduction of test-year expense by \$32,117.<sup>127</sup>

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<sup>122</sup> See *In the Matter of: The Application of River Bluffs, Inc. for a Rate Adjustment Pursuant to the Alternative Rate Filing Procedure for Small Utilities*, 2002 Ky. PUC LEXIS 113, Case No. 2001-00252, Order at \*5 (Apr. 12, 2002).

<sup>123</sup> (See generally Bluegrass Water’s Application Exhibit 17, Capital Budget for Pro Forma Adjustments (filed Feb. 27, 2023); Bluegrass Water’s Application Exhibit 18, Information about Plant Additions for Pro Forma Adjustment (filed Feb. 27, 2023); Bluegrass Water’s Application Exhibit 19, Operating Budget for Pro Forma Adjustment (filed Feb. 27, 2023).)

<sup>124</sup> (Direct Testimony of Thies, Application Exhibit 10, 19:12-13 (filed Feb. 27, 2023).)

<sup>125</sup> (*Id.* at 19:13-15, 20:13-17.)

<sup>126</sup> (*Id.* at 20:1-2.)

<sup>127</sup> (*Id.* at 20:11-12.)

Finally, Bluegrass Water has included several known and measurable adjustments related to construction projects for which the Commission has previously granted CPCNs. Specifically, Bluegrass Water seeks to recover known and measurable adjustments to the historical test year based upon the Commission’s approval of construction projects at the Woodland Acres system,<sup>128</sup> Herrington Haven system,<sup>129</sup> and Persimmon Ridge system.<sup>130</sup> These expenses are “known and measurable” because they are related to projects approved by the Commission and that Bluegrass Water is working diligently to complete pursuant to the issued CPCNs.

#### **IV. BLUEGRASS WATER’S CAPITAL STRUCTURE**

##### **A. The Commission Should Adopt Bluegrass Water’s Actual Capital Structure.**

As supported by the testimony of Dylan D’Ascendis, the Commission should authorize sewer rates based upon Bluegrass Water’s actual capital structure, which consists of 61.16% equity and 38.84% debt.<sup>131</sup> As was explained by Mr. D’Ascendis, Bluegrass Water’s actual capital structure is within the range of common equity ratios of the utility proxy group utilized by Mr. D’Ascendis.<sup>132</sup> Mr. D’Ascendis applied seven different criteria to arrive at the Utility Proxy Group, which, based upon Mr. D’Ascendis’s expertise, yielded six different companies that were

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<sup>128</sup> See *In the Matter of: Electronic Application of Bluegrass Water Utility Operating Company, LLC for a Certificate of Public Convenience and Necessity for Projects at the Woodland Acres Site*, 2022 Ky. PUC LEXIS 748, Case No. 2022-0015, Order at 9 (Sept. 1, 2022).

<sup>129</sup> See *In the Matter of: Electronic Application of Bluegrass Water Utility Operating Company, LLC for Certificates of Convenience and Necessity for Projects at the Herrington Haven Site*, 2022 Ky. PUC LEXIS 901, Case No. 2022-00102, Order at 3 (Nov. 7, 2022).

<sup>130</sup> See *In the Matter of: Electronic Application of Bluegrass Water Utility Operating Company, LLC for Certificates of Public Convenience and Necessity for Projects at the Permission Ridge Site*, 2022 Ky. PUC LEXIS 887, Case No. 2022-00046, Order at 2 (Nov. 3, 2022).

<sup>131</sup> (Direct Testimony of Dylan W. D’Ascendis, Application Exhibit 6, 16:5-6 (filed Feb. 27, 2023).)

<sup>132</sup> (*Id.* at 16:13-15.)

“fundamentally risk-comparable to the Company.”<sup>133</sup> In addition to currently being consistent with the Utility Proxy Group, Bluegrass Water’s actual capital structure is expected to be consistent with the Utility Proxy Group capital structures in the coming years.<sup>134</sup>

The Company’s current actual debt ratio is based upon the Company’s outstanding loan amount of \$2.9 million.<sup>135</sup> While the Commission previously approved Bluegrass Water to borrow up to \$5 million,<sup>136</sup> following the Commission’s approval, the lender determined that Bluegrass Water’s cash flows could not support a \$5 million credit extension. Therefore, the Company borrowed the amount that its current cash flows could support: \$2.9 million.<sup>137</sup> Accordingly, the requested rates in this proceeding, including utilization of Bluegrass Water’s actual capital structure, will allow Bluegrass Water the necessary cash flows to seek to obtain additional debt, which will move Bluegrass Water closer towards the actual 50/50 debt to equity capital structure that Bluegrass Water seeks to achieve.<sup>138</sup>

**B. The Commission Should Reject the Attorney General’s Hypothetical Capital Structure.**

The Commission should not adopt the hypothetical capital structure proposed by the Attorney General through its witness Mr. Dittmore. Unlike the testimony of Mr. D’Ascendis and the application of a proxy group to determine whether Bluegrass Water’s capital structure is

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<sup>133</sup> (*Id.* at 13:15-16; 14:14-22, 15:1-11.)

<sup>134</sup> (*Id.* at 16:16-19.)

<sup>135</sup> (*Id.* at Exhibit DWD-3 (filed Feb. 27, 2023).)

<sup>136</sup> *See In the Matter of: Electronic Application of Bluegrass Water Utility Operating Company, LLC for Issuance of Evidence of Indebtedness*, 2022 Ky. PUC LEXIS 820, Case No. 2022-00217, Order at \*5 (Sept. 28, 2022).

<sup>137</sup> (*See* Bluegrass Water’s Response to PSC 3-3 (filed Jun. 16, 2023).)

<sup>138</sup> (*See* Bluegrass Water’s Response to PSC 1-23 (filed Apr. 21, 2023) (“Debt financing necessary to reach a 50/50 capital structure is subject to cash flow requirements that Bluegrass Water is currently unable to meet.”).)

consistent with similar companies, Mr. Dittmore proposes a hypothetical capital structure based upon speculation and without any corroborating support for such application. Specifically, Mr. Dittmore alleges in Supplemental Testimony that Bluegrass Water’s equity financing is the product of “double leveraging.”<sup>139</sup> However, when asked to provide evidence to support this allegation or to provide “studies, research, literature, or articles” to support Mr. Dittmore’s Supplemental Testimony, Mr. Dittmore was unable to provide any such support.<sup>140</sup>

In addition to providing no support for his proposed hypothetical structure, Mr. Dittmore’s proposal in this case is inconsistent with testimony sponsored by Mr. Dittmore when testifying on behalf of at least one other utility. Mr. Dittmore previously testified on behalf of a utility, Kansas Gas Service, to support its capital structure.<sup>141</sup> There, while recognizing the existence of the parent entity, Mr. Dittmore’s testimony identified no concerns with “double leveraging.”<sup>142</sup> Instead, Mr. Dittmore relied upon a hypothetical capital structure solely based upon a prior condition set by the Kansas Commission, and even then, the Kansas Commission’s hypothetical 55% equity ratio structure was more favorable than the speculative ratio he proposes here.<sup>143</sup> Specifically, as part of the Kansas Commission’s approval of creation of a new parent entity, a condition was entered that “[t]he capital structure proposed in the next base rate case of ONE Gas shall be ONE Gas’s actual capital structure; however, the equity component is not to exceed

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<sup>139</sup> (*See, e.g.*, Supplemental Testimony of David Dittmore, 5:4-6 (filed Jul. 18, 2023).)

<sup>140</sup> (OAG’s Response to Bluegrass Water’s Request 1-5 (filed Jul. 14, 2023).)

<sup>141</sup> (*See generally* OAG’s Response to Bluegrass Water’s Request 1-1, Testimony of David Dittmore on behalf of Kansas Gas Service, Docket No. 16-KGSG-RTS (filed Jul. 14, 2023).)

<sup>142</sup> (*See generally* OAG’s Response to Bluegrass Water’s Request 1-1, Testimony of David Dittmore on behalf of Kansas Gas Service, Docket No. 16-KGSG-RTS (filed Jul. 14, 2023).)

<sup>143</sup> (*Id.* at 11-12 of 38.)



55%.”<sup>144</sup> Consistent with that condition, Mr. Dittmore supported a hypothetical equity ratio of 55%, noting that the actual equity ratio of ONEGas was 60.5%.<sup>145</sup> Mr. Dittmore’s testimony in that matter offered no discussion of the possibility of “double leveraging,” nor did he ever suggest that his utility client’s actual equity ratio was not “really equity” as he now speculates in this case. Notably, as Mr. D’Ascendis’s testimony shows, Bluegrass Water’s actual equity ratio is 61.16%, which is within 1% of the actual equity ratio of Kansas Gas Service.<sup>146</sup>

With Mr. Dittmore’s assumptions being supported by nothing more than speculation, and with his prior testimony showing an apparently inconsistent application of alleged “double leveraging,” the Commission should rely on the information that is clear from the record. The risks of the underlying utility operations—not the source of financing—determine whether the Company’s capital structure is reasonable, as a contrary conclusion would violate “the widely acknowledged economic ‘law of one price[.]’”<sup>147</sup> Further, contrary to Mr. Dittmore’s failure to provide any academic literature to support the assumptions he has put forth in this proceeding, Mr. D’Ascendis has provided “longstanding academic literature” that discuss the “flaws” of the double leverage approach.<sup>148</sup>

Accordingly, the Commission should set rates based upon Bluegrass Water’s actual capital structure, which is 61.16% equity to 38.84% debt.

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<sup>144</sup> (*Id.* at 11:12-14 of 38.)

<sup>145</sup> (*Id.* at 11-12.)

<sup>146</sup> Similarly, when representing Kansas Gas Service, Mr. Dittmore apparently advocated for a 14.9% rate increase, solely to the residential class. This rate increase, too, is within 1% of the rate increase originally proposed for those residential customers who are presently on the Bluegrass Water unified rate.

<sup>147</sup> (Rebuttal Testimony of Dylan D’Ascendis, 7:3-8 (filed Aug. 11, 2023).)

<sup>148</sup> (*Id.* at 8:16-25, 9:1-17, 10:1-2.)

## V. BLUEGRASS WATER'S RATE OF RETURN

Based upon its previously discussed actual capital structure, the Commission should approve the overall weighted average cost of capital of 9.77%, which includes a recommended return on common equity of 11.65% and the 6.8% cost of long-term debt as proposed by Dylan D'Ascendis and adopted by the Company.<sup>149</sup>

### A. Return on Common Equity

The Commission should approve the return on common equity of 11.65% proposed by Dylan D'Ascendis, which is the result of Mr. D'Ascendis's study of the Utility Proxy Group and application of various models to arrive at a recommended return. As was explained in detail in the Direct Testimony of Dylan D'Ascendis, his recommendation applied the Discounted Cash Flow Model ("DCF"), the Risk Premium Model ("RPM"), the Predictive Risk Premium Model ("PRPM"), and the Capital Asset Pricing Model ("CAPM") to the market data of the Utility Proxy Group. In addition, Mr. D'Ascendis also applied the same models to a proxy group of non-regulated companies.<sup>150</sup> As Mr. D'Ascendis explained thoroughly in his testimony, all common equity models used are market-based.<sup>151</sup> In other words, by relying on market data, the analysis can better control against analyst subjectivity. Application of these models results in a reliable, reasonable return on equity because use of the various market-based models "focus on different aspects of return requirements, and provide different insights to investors' views of risks and

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<sup>149</sup> (Direct Testimony of D'Ascendis, Application Exhibit 6, 53:9-10 (filed Feb. 27, 2023).)

<sup>150</sup> (Direct Testimony of D'Ascendis, Application Exhibit 6, 4:3-9 (filed Feb. 27, 2023).)

<sup>151</sup> (*Id.* at 17:15-16.).

returns.”<sup>152</sup> Application of the various models resulted in a range of common equity cost ratios between 10.13% and 11.13%.<sup>153</sup>

Mr. D’Ascendis then applied a business risk adjustment of 1% to the recommended return on common equity. His basis for doing so derived from his analysis of market data from a proxy group of six water companies,<sup>154</sup> which he chose based upon the following criteria:

- (i) They are included in the Water Utility Group of *Value Line’s Standard Edition* (January 6, 2023);
- (ii) They have 60% or greater of 2021 total operating income or 60% or greater of 2021 total assets attributable to regulated water operations;
- (iii) At the time of preparation of this testimony, they had not publicly announced that they were involved in any major merger or acquisition activity (i.e., one publicly traded utility merging with or acquiring another);
- (iv) They have not cut or omitted their common dividends during the five years ending 2021 or through the time of the preparation of this testimony;
- (v) They have *Value Line* and Bloomberg Professional Services (“Bloomberg”) adjusted Beta coefficients (“beta”);
- (vi) They have a positive *Value Line* five-year dividends per share (“DPS”) growth rate projection; and

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<sup>152</sup> (*Id.* at 18:9-12.)

<sup>153</sup> (*Id.* at 5:1-3.)

<sup>154</sup> (*Id.* at 4:5-6.)

(vii) They have *Value Line*, Zacks or Yahoo! Finance five-year earnings per share (“EPS”) growth rate projections.<sup>155</sup>

In addition, Mr. D’Ascendis also testified that “Bluegrass Water’s smaller size relative to the Utility Proxy Group companies indicates greater relative business risk for the Company because, all else being equal, size has a material bearing on risk.”<sup>156</sup>

As Mr. D’Ascendis further explained, the Company faces business risks “as compared to the Utility Proxy Group” that should be reflected in the authorized return on equity.<sup>157</sup> The additional risks faced by Bluegrass Water takes various forms, including the fact that Bluegrass Water faces operational risk from acquisition of troubled water and wastewater systems, and that Bluegrass Water is much smaller compared to the Utility Proxy Group.<sup>158</sup> While Mr. D’Ascendis testified that Bluegrass Water’s size justified a 3.91% upward adjustment, only a 1% business risk adjustment was added to the requested common return on equity.<sup>159</sup> Moreover, as a result of the additional acquisitions between Bluegrass Water’s last rate case and this rate case, Mr. D’Ascendis has recommended a lower business risk adjustment in this proceeding (1%) than was recommended in the prior rate case (1.75%).<sup>160</sup>

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<sup>155</sup> (*Id.* at 14:16-22; 15:1-8.)

<sup>156</sup> (*Id.* at 49:16-18.)

<sup>157</sup> (*Id.* at 49:11-13.)

<sup>158</sup> (*Id.* at 49:1-3, 16-18.)

<sup>159</sup> (*Id.* at 52:12-14.)

<sup>160</sup> (*Compare id.* at 52:12-14, with *In the Matter of Electronic Application of Bluegrass Water Utility Operating Company, LLC for Adjustment of Rates and Approval of Construction*, Case No. 2020-00290, Application Exhibit 8-E, 49:7-9 (filed Oct. 1, 2020).)

## **B. Long-Term Debt Cost Rate**

The Commission should approve the use of a long-term debt cost rate of 6.8%, “which reflects the actual effective cost of debt for the Company.”<sup>161</sup> Specifically, this cost of debt mirrors that recently achieved by Bluegrass Water when it closed on its recent credit facility in December 2022. The Commission should further utilize the actual cost of debt financing because it reflects the true cost of debt to the Company at the “best available rate” the Company could realize at that time and under then-existing cash flows.<sup>162</sup>

## **C. The Commission Should Reject the Attorney General’s Return on Equity**

While the Attorney General’s witness, Mr. Dittmore, did not perform a full rate of return analysis or otherwise recommend a specific rate of return, the Commission should reject any suggestion by Mr. Dittmore that the Commission simply adopt the rate of return approved in Bluegrass Water’s prior rate case.<sup>163</sup> Mr. Dittmore’s professional history does not reflect any such specific experience, much less a specific expertise with respect to return on equity.<sup>164</sup> In fact, Mr. Dittmore’s reference to the prior rate case’s rate of return was, by his own concession, merely for “illustrative purposes.”<sup>165</sup>

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<sup>161</sup> (Direct Testimony of D’Ascendis, Application Exhibit 6, 17:4-6 (filed Feb. 27, 2023).)

<sup>162</sup> (See Bluegrass Water’s Response to PSC 3-2 (filed Jun. 16, 2023); see also Bluegrass Water’s Response to PSC 1-23 (filed Apr. 21, 2023) (“Debt financing necessary to reach a 50/50 capital structure is subject to cash flow requirements that Bluegrass Water is currently unable to meet.”).)

<sup>163</sup> (See Direct Testimony of Dittmore, 30:3-5 (filed Jun. 30, 2023) (“Q: Are you providing ROE testimony in this proceeding? A: No. Instead, I simply used the ROE adopted by the Commission in the prior proceeding for illustration purposes.”))

<sup>164</sup> (See Direct Testimony of Dittmore, Exhibit DND-1 (filed Jun. 30, 2023).)

<sup>165</sup> (*Id.*)

As was explained by Mr. D’Ascendis, utilization of a return on equity authorized in a prior case is not appropriate because it does not reflect the current cost of equity.<sup>166</sup> “Simply put, historical authorized returns do not completely reflect the investor required return because the economic conditions in the past are not representative of economic conditions now.”<sup>167</sup>

## VI. BLUEGRASS WATER’S REVENUE REQUIREMENT

During the pendency of this proceeding, and largely as a result of various projects approved by the Commission, Bluegrass Water has decreased its proposed revenue requirement. Accounting for all updates to Bluegrass Water’s proposed revenue requirements, including the Company’s post-hearing data request responses, the total revenue requirement proposed by Bluegrass Water is \$3,355,541.

The final proposed revenue requirement includes adjustments to the revenue requirement that was set forth in Bluegrass Water’s Supplemental Exhibit PSC 3-7 to account for agreed upon acknowledgements and testimony presented at the hearing conducted in this matter and in Post-Hearing Data Request Responses. Specifically, the updated total revenue requirement included in this brief differs from Bluegrass Water’s Supplemental Exhibit PSC 3-7 to account for the following:

- Remote Monitoring Cost Savings – The final revenue requirement includes a net cost savings related to the installation of High Tide remote monitoring and the offsetting site visit waiver. This annual net savings is \$196,350.49.<sup>168</sup>

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<sup>166</sup> (Rebuttal Testimony of D’Ascendis, 10:13-15 (filed Aug. 11, 2023).)

<sup>167</sup> (*Id.* at 10:18-20.)

<sup>168</sup> (Bluegrass Water’s Exhibit OAG PH-2 (filed Oct. 6, 2023).) The Company acknowledges that Exhibit OAG PH-2 (filed Oct. 6, 2023) incorrectly reflects an expense for the Randview system in Column J, Row 28 of Exhibit OAG PH-2, which was inadvertently not removed with the other

- Mission Operating Income Savings – The total Operating Income Adjustment related to transition from Mission remote monitoring equipment is \$30,736.74, which was incorrectly set forth as \$16,370.47 due to a formula error in the Excel sheet filed as Bluegrass Water’s Exhibit PSC PH-6(b) (filed Oct. 6, 2023). The operating income adjustment of \$30,736.74 is comprised of (i) the total annual Mission subscription cost that will no longer be incurred and (ii) the annual depreciation expense of the Mission units that will no longer be incurred. The total annual subscription savings is \$19,719, which is derived by multiplying the annual subscription cost for Mission of \$563.40, which is set forth in the Operations Cost tab of Bluegrass Water’s Exhibit OAG PH-4 (filed Oct. 6, 2023), by the 35 Mission Units set forth on the Mission Tab of Bluegrass Water’s Exhibit OAG PH-4 (filed Oct. 6, 2023). The avoided annual depreciation expense for this equipment is \$11,017.74, which is the product of the total cost of the Mission equipment as reported in Bluegrass Water’s response to PSC 3-9, multiplied by the 6.67% depreciation rate as described in Mr. Spanos’s testimony.<sup>169</sup>
- Randview Operation Expense – As was acknowledged at the hearing and confirmed in Bluegrass Water’s Response to OAG PH-3 (filed Oct. 6, 2023), the overall revenue requirement impact of the Randview sale is \$59,208.<sup>170</sup> The \$59,208 impact is comprised of the \$7,779 set forth in Mr. Thies’ Rebuttal Testimony, plus the removal of \$51,429 of

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Randview expenses. If the value in Column J, Row 28 is deleted from the live Excel worksheet filed by the Company, with formulas intact, the formula will automatically populate the correct operational savings value of \$196,350.49.

<sup>169</sup> (See Direct Testimony of Spanos, Application Exhibit 14, Exhibit JJS-1 at VI-4 (filed Feb. 27, 2023) (identifying Communication Equipment as having a 6.67 rate).)

<sup>170</sup> (See Bluegrass Water’s Response to OAG PH-3(b) (filed Oct. 6, 2023).)

revenues received from Randview, which lowers the overall revenue deficiency of Bluegrass Water.

## VII. BLUEGRASS WATER'S RATE DESIGN

The Commission should approve the rate design supported by the testimony of Tim Lyons, which, as a result of the fact that most service provided is unmetered, adopts the customer equivalencies approved by the Commission in Bluegrass Water's last rate case, and proposes that the revenue requirement be allocated 77.28% to the unmetered services and 22.72% to metered customers.<sup>171</sup> Further, Mr. Lyons testimony incorporates the Company's proposal to move all Bluegrass Water systems subject to this rate case to a unified rate.

### A. The Commission Should Adopt the Unified Rate for All Systems.

Bluegrass Water proposes to bring all of the systems included in this rate case onto a unified rate across the Commonwealth.<sup>172</sup> "The Commission has consistently supported the concept of a unified rate structure to encourage consolidation of water systems and to improve water service in the Commonwealth."<sup>173</sup>

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<sup>171</sup> (Direct Testimony of Timothy Lyons, Application Exhibit 11, 7:5-6 (filed Feb. 27, 2023).)

<sup>172</sup> For clarity, the systems subject to Bluegrass Water's two most recent acquisition cases would not be subject to the proposed unified rate for all other systems. See *Electronic Joint Application of Bluegrass Water Utility Operating Company, LLC for Approval of Acquisition and Transfer of Ownership and Control of Assets of Magruder Village Water Company*, Case No. 2023-00218, Application ¶ 18 (filed Jun. 29, 2023) ("Bluegrass Water will provide continuity of rates and service to the current customers of Magruder Village."); *Electronic Joint Application of Bluegrass Water Utility Operating Company, LLC for Approval of Acquisition and Transfer of Ownership and Control of Assets of Commonwealth Wastewater Systems, LLC, Yung Farm Estate Homeowners' Association, Inc., and Moon River Marina and Resort, LLC*, Case No. 2023-00181, Application ¶ 27 (filed May 26, 2023) ("Bluegrass Water will provide continuity of rates and service to the current customers of the Transferring Entities.").

<sup>173</sup> *In the Matter of: Application of Kentucky-American Water Company for an Adjustment of Rates Supported by a Fully Forecasted Test Year*, 2013 Ky. PUC Lexis 936, Case No. 2012-00520, Order at \*119 (Oct. 25, 2013); see also *In the Matter of Electronic Application of Kentucky-*



In addition, in its previous rate case, the Commission noted Bluegrass Water’s plan for a unified rate across its Kentucky systems with approval. Specifically, the Commission noted, “[t]here are reasons for approving a unified rate as opposed to a single rate for each system, including that a unified rate is likely to promote regionalization, which should drive down costs in the long term by allowing utilities to take advantage of economies of scale, and that a unified rate will serve to levelize rates in the long term so that each system will not experience a significant rate shock every time it requires significant investment or some unexpected cost, which all systems will experience at some point.”<sup>174</sup> “The Commission finds that the proposed unified monthly flat rate design, with wastewater multi-family dwellings and commercial customers monthly rates based on residential equivalency, should be approved for Bluegrass Water’s customers.”<sup>175</sup>

As noted above, the Commission has previously treated unified rates with approval. Here, Bluegrass Water’s proposed unified rate is designed to meet the needs of its customers across all its Kentucky systems. The Attorney General’s expert even testified that, “[a]bsent rate consolidation, uneven deployment of system capital expenditures would significantly increase rate volatility among individual systems with their own rate structures.”<sup>176</sup> A unified rate will allow for the financial burdens common to all systems to be distributed in a beneficial manner to each of

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*American Water Company for an Adjustment of Rates*, 2019 Ky. PUC Lexis 663, Case No. 2018-00358, Order at \*115 (Jun. 27, 2019) (“Consistent with Commission precedent and based on the evidence in this case, the Commission now reaffirms those findings and, therefore, further finds that the proposed unified tariff is reasonable and should be approved.”)

<sup>174</sup> *In the Matter of Electronic Application of Bluegrass Water Utility Operating Company, LLC for an Adjustment of Rates and Approval of Construction*, Case No. 2020-00290, Order at \*13 (Aug. 2, 2021).

<sup>175</sup> *Id.* at \*113; (see also Direct Testimony of Dittmore, 33:12-17 (filed Jun. 30, 2023) (“The Commission adopted a unified rate structure to be in the public interest.”).)

<sup>176</sup> (Direct Testimony of Dittmore, 33:15-17 (filed Jun. 30, 2023).)

the ratepayers, and allow the systems—which are historically distressed—to be brought into and kept in compliance and to continue providing safe and reliable service.

Accordingly, the Commission should continue its “consistent support” of unified rate structures and approve Bluegrass Water’s proposal to bring all of the Kentucky systems subject to this rate proceeding onto a unified rate tariff.

**B. The Commission Should Approve the Proposed Cost Allocation.**

The Commission should likewise approve Mr. Lyons’s proposal to allocate 77.28% of the revenue requirement to unmetered service and 22.72% to metered service, utilizing the customer equivalencies approved by the Commission in Bluegrass Water’s last rate case.<sup>177</sup>

As Mr. Lyons explained in his testimony, he did not perform a “traditional class” cost of service study in this proceeding because Bluegrass Water does not have demand information that would allow for the performance of such a study.<sup>178</sup> In the absence of this information, one common method is to utilize customer equivalencies.<sup>179</sup> In completing his rate design proposal, Mr. Lyons utilized the customer equivalencies included in Bluegrass Water’s current unified rate and approved by the Commission in Bluegrass Water’s last rate case, which established: (1) an equivalency of 2.5 times that of a typical residential customer for unmetered commercial/non-residential customers; and (2) an equivalency of 0.75 times that of the typical residential customer

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<sup>177</sup> See *Pub. Serv. Comm’n of Ky. v. Commonwealth*, 320 S.W.3d 660, 666 (Ky. 2010) (“[F]air, just and reasonable is not inconsistent with appropriate classifications that distinguish among customers, service and rates.”).

<sup>178</sup> (Direct Testimony of Lyons, Application Exhibit 11, 4:13-18 (filed Feb. 27, 2023)).

<sup>179</sup> (*Id.* at 4:21-22.)

for multifamily unit customers.<sup>180</sup> Mr. Lyons testified that he believes these customer equivalencies fairly allocate the cost of service.<sup>181</sup>

Based upon the output of that analysis, Mr. Lyons then proposes to slightly alter the cost allocation between unmetered service and metered service to 77.28% unmetered and 22.72% metered to reflect bill continuity and cost of service considerations. This results in a slight 4.2% shift from unmetered to metered service.<sup>182</sup> First, Mr. Lyons recommends this shift to address bill continuity concerns because, without this shift, the unmetered customers (who are typically residential customers) would see a 21.9% rate increase following this case, after many of these same unmetered customers already saw rates almost double in the last rate case.<sup>183</sup> This is compounded by the fact that the metered customers in the last rate case saw no increase,<sup>184</sup> and the Delaplain customers, who were not subject to the last rate case, have not seen a rate increase from the prior owner in over thirty years.<sup>185</sup> Thus, Mr. Lyons's proposal does, at least in some measure, help improve affordability for Bluegrass Water's predominantly residential customers in a fair, just, and reasonable manner.

Additionally, Mr. Lyons noted the recently approved construction at the Delaplain facility, which he understood was necessary to increase capacity to account for the growing demand of

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<sup>180</sup> (*Id.* at 5:1-4.)

<sup>181</sup> (*Id.* at 5:7-10.)

<sup>182</sup> (Rebuttal Testimony of Timothy Lyons, 5:18-20, 6:3-4 (filed Aug. 11, 2023).)

<sup>183</sup> (*Id.* at 6:5-10.)

<sup>184</sup> (*Id.* at 6:6-7)

<sup>185</sup> *See In the Matter of: the Application of Delaplain Disposal Company for a Certificate of Public Convenience and Necessity and to Increase Rates*, Case No. 89-060, Order (Nov. 8, 1989).

metered customers at the Delaplain system since its original construction. Thus, the shift is also appropriate to attempt to align with the general principle that the cost-causer should bear costs.<sup>186</sup>

**C. The Attorney General’s Rate Design Proposal Should be Rejected.**

As previously indicated, the Attorney General has, through its witness, David Dittimore, generally supported the proposal to move all systems to a unified rate, recognizing that “[a]bsent rate consolidation, uneven deployment of system capital expenditures would significantly increase rate volatility among individual systems with their own rate structures.”<sup>187</sup> Mr. Dittimore then proposed to apply his proposed revenue requirement based on a rate design that would “equalize fixed rates among the customer classes.”<sup>188</sup> Mr. Dittimore’s proposals relating to the rate design should be rejected for numerous reasons, which were outlined in Mr. Lyons’s rebuttal testimony.

First, the Attorney General’s proposal does not include a fixed charge for metered customers, which fails to align “the Company’s charges and its cost of service across the Kentucky systems.”<sup>189</sup> Rather, Mr. Dittimore simply proposes to collect the revenue requirement for metered customers entirely through a volumetric charge.<sup>190</sup> Second, Mr. Dittimore’s Exhibit DND-13 also eliminated the higher fixed charge for the Permission Ridge non-residential customers, which was based upon a customer equivalency of 2.5x that of the residential class.<sup>191</sup> This is contrary to the Commission’s last rate case order; it also ignores that the Persimmon Ridge non-residential customers are expected to utilize more wastewater services than residential

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<sup>186</sup> (Rebuttal Testimony of Timothy Lyons, 6:11-15 (filed Aug. 11, 2023).)

<sup>187</sup> (Direct Testimony of Dittimore, 33:15 (filed Jun. 30, 2023).)

<sup>188</sup> (*Id.* at 33:19-20.)

<sup>189</sup> (Rebuttal Testimony of Lyons, 3:16-18 (filed Aug. 11, 2023).)

<sup>190</sup> (*See* Rebuttal Testimony of Lyons, 3:14-15 (filed Aug. 11, 2023) (“the AG’s rate design for metered customers does not include a fixed monthly charge.”).)

<sup>191</sup> (*Id.* at 4:3-7.)

customers.<sup>192</sup> Thus, the Attorney General’s proposal fails to fairly allocate costs to those customers causing the costs to be incurred, a violation of widely accepted rate-making principles.

Finally, while Mr. Dittmore does not directly discuss how costs were allocated between metered and unmetered service, his proposal does not appear to incorporate the Company’s proposed cost allocation of 22.72% to metered service. For the reasons discussed herein, the Company’s proposed allocation results in fair, just, and reasonable rates, and the Commission should reject any suggestion from Mr. Dittmore that costs should not be allocated as proposed by the Company. Indeed, Mr. Dittmore’s testimony indicates that he failed to account for the Delaplain CPCN, the Site Visit Waiver (associated with the installation of the High Tide remote monitoring equipment), and the proposed Randview sale, all of which have been approved by the Commission.<sup>193</sup> When asked why Mr. Dittmore failed to account for CPCNs that had already been approved by the Commission, Dittmore admitted that he did not know the CPCNs had been granted when he filed his testimony.<sup>194</sup> Accordingly, Mr. Dittmore’s proposals related to rate design (as well as the overall requested revenue requirement, including known and measurable adjustments) are generally unreliable because they failed to account for the ordinary cost causation principles identified and outlined in the Testimony of Timothy Lyons.

**D. Scott County’s Proposals Should be Similarly Rejected.**

The Commission should similarly reject Scott County’s proposal, as it is clear from Scott County’s own testimony that Scott County has intervened to advocate on behalf of the commercial customers at the Delaplain service area, which will harm Bluegrass Water’s residential customers

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<sup>192</sup> (*Id.* at 4:8-10.)

<sup>193</sup> (Direct Testimony of Dittmore, at 14:15-22 (filed Jun. 30, 2023).)

<sup>194</sup> (OAG’s Response to Bluegrass Water’s Data Request 1-18 (filed Jul. 14, 2023).)

across the entire Commonwealth, including the Scott County residential customers served by the Delaplain system.

As was pointed out in the Rebuttal Testimony of Brent Thies, Scott County's proposals overwhelmingly work to the advantage of the Delaplain commercial class. First, Scott County has opposed apportioning 22.72% of the revenue requirement to metered service, instead seeking to have the apportionments mirror those implicit in current rates.<sup>195</sup> This will of course result in more of the approved revenue requirement (i.e., a greater rate impact) being borne by residential customers, so that the Delaplain commercial class can pay as little as possible. The Scott County proposal, therefore, fails to recognize that significant costs are being caused by the commercial class at the Delaplain system, and general rate-making principles fairly allocate those costs to the class causing the costs.

For example, the Commission has previously acknowledged that at the time Bluegrass Water purchased the Delaplain system, "the maximum monthly average daily flow and peak flows were too great relative to the existing rated capacity and plant size, noted exceedances in ammonia, [biochemical oxygen demand], and [total suspended solids], and identified deficiencies at the plant causing it to exceed permitted limits or otherwise making it unsafe to operate."<sup>196</sup> Simply put, the Delaplain system was inadequate to handle the wastewater capacity it was seeking to serve, largely due to the growth of the commercial class at that system since its construction. This fact is exhibited by the Division of Water's refusal to allow Bluegrass Water to add another commercial

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<sup>195</sup> (Direct Testimony of Ariel Miller, 10:14-17 (filed Jun. 29, 2023).)

<sup>196</sup> *In the Matter of: Electronic Application of Bluegrass Water Utility Operating Company, LLC for Certificates of Convenience and Necessity for Projects at the Delaplain Site*, 2023 Ky. PUC LEXIS 208, Case No. 2022-00104, Order at 3-4 (Mar. 30, 2023).

user to the system. Specifically, Bluegrass Water sought to accommodate the “R and L Carriers Georgetown Development Project,” but the Division of Water determined that the Delaplain facility was already out of compliance, would not allow additional flows, and issued a letter refusing any further extensions of service to the Delaplain facility.<sup>197</sup> As the testimony of Mr. Lyons explains, it is fair, just, and reasonable to allocate additional costs to the metered customers at the Delaplain system because Bluegrass Water is (as represented by the CPCN granted in Case No. 2022-00104) expending costs to accommodate additional flow at that facility for commercial customers, like “R and L Carriers Georgetown.”

The Commission should also reject Scott County’s phased-in rate proposal because it fails to produce rates that will support Bluegrass Water’s financial integrity. Moreover, due to its failure to account for carrying costs associated with the failure to recover the Company’s approved revenue requirement, the Scott County proposal may also result in an unconstitutional taking if ordered by the Commission. At a more purely operational level, it will also unreasonably limit the Company’s cash flows, thereby further frustrating the Company’s efforts to move toward the 50/50 equity ratio that the Commission has established as the Company’s goal.<sup>198</sup>

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<sup>197</sup> (See Bluegrass Water’s Response to Scott County Data Request 1-7 (filed May 19, 2023) (cross-referencing to a copy of the quoted Division of Water letter in the record of Case No. 2022-00104); see also Bluegrass Water’s Supplemental Response to Staff Data Request 1-25, Case No. 2022-00194 (filed Mar. 16, 2023) (“In other words, the Division of Water has prohibited Bluegrass from adding any customers in the Delaplain service area without preapproval by the Division of Water until the environmental issues are remedied, even though Bluegrass has an obligation as a regulated utility to serve all customers in the Delaplain service area.”).)

<sup>198</sup> (See Bluegrass Water’s Response to PSC 3-3 (filed Jun. 16, 2023); see also Bluegrass Water’s Response to PSC 1-23 (filed Apr. 21, 2023) (“Debt financing necessary to reach a 50/50 capital structure is subject to cash flow requirements that Bluegrass Water is currently unable to meet.”).)

As was explained in the Rebuttal Testimony of Timothy Lyons, Scott County’s proposed phase-in approach could have negative impacts on the Company and its customers for various reasons. First, the Scott County phase-in approach fails to “reflect carrying-costs associated with the unrecovered portion of the authorized revenue requirement.”<sup>199</sup> Because a phase-in of rates will necessarily mean that the Company is recovering less than the revenue requirement approved by the Commission, application of carrying costs is necessary to ensure that the “Company’s revenues under a phase-in of rates are the same as under no phase-in of rates.”<sup>200</sup> Indeed, without an application of carrying costs, the Commission’s final Order would be subject to attack under the Due Process Clause because the Commission would essentially be ordering that the Company was legally authorized to recover a certain revenue requirement, but then issuing an Order that made it legally impermissible to recover those amounts. Second, if the Scott County proposal had properly accounted for carrying costs, it would negatively affect the ratepayers subject to the phase-in because, over time, the carrying costs actually result in ratepayers paying more for their utility services.<sup>201</sup>

Accordingly, the Commission should reject the proposals of Scott County as they do not result in fair, just, and reasonable rates for all Bluegrass Water ratepayers. Rather, Scott County’s proposals would largely advantage only the metered, commercial class served by the Delaplain system in Scott County.<sup>202</sup>

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<sup>199</sup> (Rebuttal Testimony of Lyons, 7:1-2 (filed Aug. 11, 2023).)

<sup>200</sup> (*Id.* at 7:3-4.)

<sup>201</sup> (*Id.* at 7:9-15, 8:1-10.)

<sup>202</sup> *See* KRS 278.170(1) (“No utility shall, as to rates or service, give any unreasonable preference or advantage to any person or subject any person to any unreasonable prejudice or disadvantage, or establish or maintain any unreasonable difference between localities or between classes of



## VIII. CONCLUSION

For the reasons set forth herein, and as otherwise established in this proceeding, Bluegrass Water respectfully requests that the Commission grant its Application for an Adjustment of Sewer Rates and permit it to adjust its wastewater rates.

Respectfully submitted,

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service for doing a like and contemporaneous service under the same or substantially the same conditions.”).

**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.

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