COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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

ATTORNEY GENERAL'S POST-HEARING RESPONSE BRIEF

The Attorney General of the Commonwealth of Kentucky ("Attorney General"), through his Office of Rate Intervention, hereby provides the following Post-Hearing Response Brief related to the Hearing held on September 19, 2023 through September 20, 2023 regarding the request of Bluegrass Water Operating Company, LLC (hereinafter "Bluegrass Water," "Bluegrass," or the "Company") for an increase in rates and the associated Briefs filed on October 27, 2023.

Bluegrass is to be commended for the improvements it has made to the systems it owns. However, just as with all other utilities operating within the Commonwealth, pursuant to KRS 278.010(1), Bluegrass is authorized to, "demand, collect and receive fair, just and reasonable rates,"—no more and no less. While the Company has recognized several adjustments to its revenue proposal in response to efforts of the Attorney General, Scott County, and Commission Staff, several issues remain in dispute. The issues where the Attorney General and the Company fundamentally disagree include: (1) the acquisition premium, (2) bad debt expense, (3) business development expense, (4) late fee revenue, (5) rate of return, and (6) capital structure.

I. Acquisition Premium

Bluegrass argues, "[t]he Commission should authorize Bluegrass Water to recover the acquisition adjustments requested in this proceeding,"[1] and that recovery is authorized under the standard set out in the *Delta Test* and KRS 278.295 where applicable.[2]

As set forth fully in the Attorney General's Initial Brief, application of those standards requires the Commission to determine the rates charged of new and existing customers would not be "adversely impact[ed]" through recovery of the acquisition premium.[3] Given the extreme rate increases at issue here, it is unreasonable to argue that the requested recovery of acquisition premiums does not adversely impact rates. Even assuming the Company could meet the other factors of the standard, which is not conceded, this factor alone forecloses the possibility of recovery of those premiums.

Further, the Company fails to provide support for its statement that prior owners failed to record land value on their books and records.[4] No accounting references are cited to support the implication that acquirers of utility systems should be allowed to record land at its market value at the date of purchase rather than carry forward the book value of land at the date of the acquisition. The Company altogether failed to support its bare assertion that market values should be used in utility

[1] Company Brief at 18.
[2] Company Brief at 18-19.
[3] Attorney General's Brief at 9-11. In the case of KRS 278.295, the prohibited adverse impact under the Delta Test is modified to "material" adverse impacts.
[4] Company Brief at 20.

accounting for acquisitions rather than the book value of the acquired systems. To properly consider the Company's position requires a complete history of the accounting underlying prior systems acquisitions, which the Company failed to provide. The book value of land may be understated on the books of prior systems. But if so, it raises the question of whether the costs for other plant accounts were overstated such that the total utility assets were accurate. The Company's assertion that total utility assets are understated, simply because the cost assigned to land is zero, is a gross oversimplification.

II. Bad Debt Expense

Bluegrass is critical of Witness Dittemore's recommendations related to Bad Debt Expense, arguing that he has a "flawed understanding of the evidence."[5] This is false. The Company simply fails to acknowledge now what it already admitted in discovery. Regarding its proposed level of bad debt expense, the Company admitted, "[t]here is no significant analytical support to provide."[6] Witness Dittemore relied on actual amounts written off by the Company. The Commission should not agree to the Company's hypothetical and unsupported level of bad debt expense.

III. Business Development Expense

The Commission should closely scrutinize the Company's exclusion of business development expense. As discussed in the Attorney General's Initial Post-Hearing Brief, the proposed excluded amounts appear to be unreasonable.[7] The Company

[5] Company Brief at 30.
[6] Company Response to AG Data Request 2-63.
[7] Attorney General's Brief at 11-12.

correctly points out that they have excluded certain business development expenses from recovery in rates, but the amount of these values is questionable. Because the Company tightly controls the information needed to make such calculations, this is a difficult issue for third parties to scrutinize. In addition to taking any action necessary to adjust revenue here, the Attorney General again urges the Commission to order the Company to conduct a detailed study of this issue to arrive at a more reasonable excludable value for business development expense.

IV. Late Fee Revenue

Bluegrass represented that should it be "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."[8] Implicit in that statement is that Bluegrass is seeking to generate revenue now, but not use that revenue to offset current rates. This is unacceptable. By urging the Commission to approve a fee, but not recognizing the revenue generated by that fee until "future rate cases," the Company is asking the Commission to approve unfair, unjust and unreasonable rates. Under the Company's proposal, the revenue generated by the proposed late fee accruing prior to future rate cases would be a windfall to the Company, creating returns in excess of required revenue. Such a proposal is unreasonable, and the Commission should not approve such a windfall.

[8] Company Brief at 33.

V. Capital Structure

The Commission should reject the Company's hypothetical capital structure and impute a capital structure that forecloses the possibility of a windfall to the Company based on double-leveraging. As discussed in the Attorney General's Initial Brief, the Company failed to support its proposed hypothetical capital structure.[9] The Company bears the burden of establishing the validity of its capital structure and failed to do so. It should not be rewarded for this failure by imputing a hypothetical capital structure that could result in a windfall return.

The Company's criticism of Witness Dittemore's failure to make a similar argument in an entirely distinguishable Kansas matter is flawed. The Company argues that, "Mr. Dittemore relied upon a hypothetical capital structure solely based upon a prior condition set by the Kansas Commission…"[10] Bluegrass attempts to portray this reliance as a willing disregard on behalf of Witness Dittemore for the actual capital structure of the utility in question. However, what Bluegrass fails to acknowledge or fails to understand is that the "prior condition" was based on the capital structure of the utility's parent.

As is the case here, the capital structure of the utility at issue did not present an accurate reflection of its financing costs. In order to correct this problem, the parties in Kansas agreed that the capital structure of the parent company should be imputed to the subsidiary. By doing so, the potential for double-leveraging was rendered a non-issue. The utilization of the parent's capital structure when the

[9] Attorney General's Brief at 13-16.
[10] Company Brief at 37.

subsidiary's capital structure was unreasonable is what the Attorney General and Witness Dittemore's attempted to explore here. But the Company vigorously resisted those attempts. It should not be rewarded for doing so.

VI. Rate of Return

Bluegrass urged the Commission to reject the previously-approved Return on Equity discussed by Witness Dittemore, because, in part, "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."[11] While it is true that economic conditions change over time and Witness Dittemore did not perform a full Return on Equity analysis, it does not follow that Witness D'Ascendis' proposal should be summarily adopted as a result. As discussed in the Attorney General's Post-Hearing Brief, Witness D'Ascendis' recommendation is based in part on conclusions expressly rejected in the Company's previous rate case and under Commission precedent (e.g. business risk adjustment). Thus, even if the Commission is not inclined to directly reauthorize the previously authorized Return on Equity, the Commission should be guided by the same principles it considered in the previous rate case in order to arrive at a fair, just, and reasonable Return on Equity. The Return on Equity proposed by Witness D'Ascendis and the Company simply does not meet those standards.

[11] Company Brief at 43.

VII. Conclusion

As previously stated, the vast majority of Bluegrass' ratepayers have already been subjected to substantial rate increases. Further increases for those ratepayers are not justified at this time. As for Bluegrass' ratepayers not yet placed on the unified rate schedule and faced with the prospect of substantial rate cases for the first time, the Commission should exercise its discretion to limit the approved increase to the minimum level possible, which allows Bluegrass to recover its legitimate costs and earn a reasonable return thereon.

Respectfully submitted,

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Certificate of Service and Filing

Pursuant to the Commission's Orders and in accord with all other applicable law, Counsel certifies that, on November 9, 2023, a copy of the forgoing was served via the Commission's electronic filing system.

this 9th day of November, 2023.

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Assistant Attorney General