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

In The Matter Of:

**THE APPLICATION OF THE
MARTIN COUNTY WATER
DISTRICT FOR ALTERNATIVE
RATE ADJUSTMENT**

Case No. 2018-00017

**MARTIN COUNTY CONCERNED CITIZENS, INC.'S
RESPONSE TO STAFF REPORT**

Martin County Concerned Citizens, Inc. ("MCCC"), by and through counsel, and pursuant to the Commission's Orders of February 20 and June 7, 2018 and 807 KAR 5:076 §11, submits these objections to the Staff Report on the Martin County Water District ("the District") entered on May 22, 2018.

I. Statement of the Case

On January 16, 2018, the District filed its Alternative Rate Adjustment ("ARF") application, asking for an extraordinary rate increase of nearly 50%. In its cover letter, the District asked that "an emergency rate be approved" because of its "dire financial situation." Based on MCCC's review of the Commission's records, it had been nearly eight years since the District had sought a rate increase from the Commission. *See* 2010-00300. On January 22, 2018, the Commission ordered that a hearing be held on January 26, 2018 on the request for an emergency rate increase. MCCC moved to intervene on January 23, 2018, and intervention was granted on February 2, 2018.

At the hearing, the Commission received testimony regarding the District's dire financial status. The District's accountant and board chair testified that without some immediate infusion of funds, the District could only continue to operate for a few months. The Commission also received testimony regarding the District's outstanding accounts

payable and accounts receivable. On February 19, the Commission ordered that another hearing be held on February 28. At the second hearing, the Commission heard testimony regarding the overall lack of internal controls on employee spending and purchase orders. Linda Sumpter, the District's accountant testified that a new interim General Manager had been hired, who would work on internal controls for fuel purchases and purchase orders.

On March 16, 2018, the Commission ordered a 17.5% emergency interim rate increase subject to refund. In the same Order, the Commission also imposed a Debt Service Surcharge of \$4.19 per customer per month. According to the Order, the surcharge is to remain in effect until all accounts payable existing before April 1, 2018 are discharged. All monies collected from the surcharge are to be put into a separate account, and any disbursements from that account must be preapproved by the Commission. The Order required strict monthly financial reporting from the District regarding its financial situation.

On May 31, 2018, the Commission held a hearing in its ongoing Investigation into the Operating Capacity of the Martin County Water District, Case Number 2016-00142. At that hearing, the District's board treasurer and accountant both testified that the financial situation of the District had improved, that it was no longer in danger of collapse. More specifically, the District's accountant, Linda Sumpter, testified that the District had been able to cut its costs by 17% between January and April 2018. Based on Ms. Sumpter's testimony, that significant improvement in the District's finances occurred prior to the District's implementation of the 17.5% emergency interim rate increase.

II. Hearing

By Order of June 28, 2018, the Commission set a hearing in this matter for August 7, 2018. MCCC had intended to request a hearing primarily to determine the amount by which the District's revenue needs have decreased since its test year of 2016. Such request is now moot as a result of the Commission's June 28, 2018 Order.

III. MCCC's Position

MCCC agrees with the Staff that the District's application materials and the information and testimony received during the course of this matter do not support the full rate increase requested by the District.

MCCC's position is that because of the extraordinary circumstances surrounding this case, no additional rate increase should be granted at this time. It is clear from the evidence that has been uncovered in this matter and in the Commission's investigation, Case Number 2016-00142, that the record of the District's operating expenses for 2016 cannot be relied on as a guide to the actual revenue needs of the District. Because of the inherent unreliability of the test year figures, MCCC believes that, as a matter of law, the Commission could deny any increase in rates and require a refund of the interim rate increase amounts because the District has failed to meet its burden to demonstrate that the rate increase it seeks is just and reasonable. *See* KRS 278.190(2).

While MCCC believes that, as a matter of law, the District has failed to meet its burden to show the requested increase is just and reasonable, MCCC is hopeful that the District is moving forward with concrete plans to correct past problems with mismanagement and improve its operations so that it can provide safe, reliable water to all of its customers. Some level of additional revenue is necessary to ensure that the

District is able to begin the slow process of recovery. For that reason, MCCC recommends that no additional rate increase be instituted, but that the interim increase of 17.5% remains in effect.

Furthermore, before implementing any final rate increase, the Commission should be satisfied that the District is implementing adequate spending controls and is properly managing its operations. At this point, the District's fuel purchase and purchase order procedures appear inadequate to ensure that spending is properly controlled. Likewise, the District has yet to hire a permanent General Manager. It therefore appears unlikely that the District will have stabilized its operations by the statute's October 16, 2018 deadline. *See* KRS 278.190(3). MCCC therefore asks that any final order of the Commission contain the same type of financial reporting requirements as those contained in the March 16 Order granting the interim rate increase.

Regardless of the Commission's decision on the future rates of the Water District in the present case, because of the unreliability of test year data in this matter, MCCC encourages the Commission to order that the Water District file another alternate rate filing case based on a test year ending December 31, 2018, no later than April 30, 2019.

IV. Comments to the Staff Report

Alternatively, MCCC provides the following specific objections to the staff report and its overall recommendation of a rate increase of 23.70%.

1. The District's Cost Savings Represent Known and Measurable Changes to the Test-Year Revenue Requirements

The District has been working to stabilize its operations and it is to be applauded for that necessary work. Prior to this year, it has been shown that the District wasted a lot of its customer's money because of its failure to have proper controls on spending. The

inefficiencies in the District's operations are not confined merely to spending practices. The District's revenue needs as represented in its test year are bloated for other reasons as well. The District pays a premium for all goods and services because of its failure to pay its bills on time. The District relies heavily on employee overtime hours, which disincentivizes employees from working efficiently. The District provides very generous employee benefits. And, of course, there is the fundamental inefficiency of paying to move and treat water, over 60% of which runs out into the ground. It is beyond doubt that the revenue requirements of 2016 are in excess of what is actually needed to run the District, if the District were managed efficiently. MCCC recognizes that the Commission's regulatory standard is that the test year operations must be adjusted to account for known and measurable changes. At the very least, MCCC respectfully requests that the Commission determine the percentage by which each category of expenses has been reduced during 2018 and should adjust each test year expense category so that the Pro Forma expenses reflect the reduction. To do otherwise would incentivize backsliding and risk undoing some of the gains that have been made since the new board took control in January 2018.

2. The Debt Service Surcharge Should Be Eliminated

The \$4.19 Debt Service Surcharge should be eliminated.¹ The surcharge constitutes retroactive ratemaking. This surcharge was established in order to allow the District to pay its accounts payable. See Order dated March 16, 2018, at 10. Martin District introduced an Exhibit that stated the accounts payable balance to be \$808,209 as

¹ Unlike the Debt Service Surcharge, MCCC has no objection to the imposition of a reasonable Capital Project Surcharge with the same reporting and operational requirements that the Commission imposed on the Debt Service Surcharge.

of December 31, 2017, of which \$616,882 was over 90 days past due. That amount of \$808,209 reflects some of the District's past expenses that should have been paid for through then-existing rates. The \$4.19 surcharge is estimated to generate \$163,187 annually for the District, which is the same amount as the District proposed to recover in base rates for the annual debt service of a non-existent five-year loan. See id.; Application, Attachment 4, Pro Forma adjustment (I).

The Commission has found similar proposed surcharges to violate the principle of improper retroactive ratemaking. Johnson County Gas Company ("Johnson County") proposed a surcharge that would collect \$39,000 for five years to pay \$195,000 to creditors identified in a bankruptcy action. See Johnson County Gas Co., Case No. 2012-00140 (Ky. PSC June 18, 2013). The Commission refused to authorize the surcharge to pay the utility's creditors, stating:

The costs which gave rise to the filing of Johnson County's Plan are recurring costs of operations, some of which were recoverable under its Gas Cost Adjustment mechanism, and some of which it could have recovered had it timely filed for a base rate increase.

In general, asking today's customers to pay amounts related to costs incurred prior to the filing of Johnson County's Plan will result in generational inequities in that some current customers likely were not customers when those costs were incurred. The ratemaking process is prospective in nature, except in the case of after-the-fact adjustments such as the Fuel Adjustment Clause applicable to our jurisdictional electric utilities. To allow the recovery Johnson County requests would constitute inappropriate retroactive ratemaking.

Id. at 6.

Martin District's request is virtually identical to Johnson County's request. Both surcharges were designed to pay off previous expenses. Both surcharges were designed

to span a five-year period. The Commission appropriately found that Johnson County's current customers should not pay for past expenses that may have been incurred when they were not customers. In the present case, the Commission should make the same finding and declare that the surcharge paid by Martin County citizens constitutes inappropriate ratemaking.²

3. Depreciation Expense

Staff decreased Depreciation Expense by \$87,953, the amount calculated in Martin District's Application. It appears that depreciation expense should be reduced further. The District indicates that it relied on NARUC's publication "Depreciation Practices for Small Water Utilities," which includes a Figure with ranges of depreciation rates. In its Application, the District included depreciation expense at below the range identified in the NARUC publication. One reason why the District's depreciation expense is inflated is that it failed to consider the salvage value of the assets. Because the Staff accepted the District's proposed depreciation expense and the only evidence to support the depreciation expense requires consideration of salvage value, MCCC objects to the Staff's position on depreciation expense.

4. Other Issues

MCCC has identified other issues from the Staff Report that it may seek to explore at the hearing in this matter. Issues such as the accuracy of water loss reports, gains on the sale of utility property, bad debt, and additional working capital (or debt service coverage) are among topics that MCCC will likely address at the hearing. To the

² To the extent that the Commission permits the District to continue to collect the surcharge, MCCC emphasizes the need for the Commission's continued implementation of and the District's strict compliance with reporting and operational requirements. However, in the event that the Commission agrees with MCCC and eliminates the Debt Service Surcharge, MCCC nonetheless recommends that periodic reports documenting payments on accounts payable be filed with the Commission.

extent required by 807 KAR 5:076, MCCC objects to the findings of the Staff Report, pending the evidence produced at the hearing in this matter.

V. Conclusion

WHEREFORE, the MCCC respectfully asks the Commission to consider these Comments when reviewing the evidentiary record in order to set a fair, just, and reasonable rate for the customers of the Martin County Water District. MCCC also reserves its right to object to any other issues in the Staff Report that arise during the August 7, 2018 hearing.

Respectfully Submitted,



Mary Varson Cromer
Appalachian Citizens' Law Center, Inc.
317 Main Street
Whitesburg, Kentucky 41858
Telephone: 606-633-3929
Facsimile: 606-633-3925
mary@appalachianlawcenter.org

and

STURGILL, TURNER, BARKER & MOLONEY,
PLLC
James W. Gardner
M. Todd Osterloh
333 W. Vine St., SUITE 1500
Lexington, Kentucky 40507
Telephone: 859-255-8581
Facsimile: 859-231-0851
jgardner@sturgillturner.com
tosterloh@sturgillturner.com

Counsel for MCCC

DATED: June 29, 2018

CERTIFICATE OF SERVICE

Pursuant to 807 KAR 5:001 Sec. 6, I, M. Todd Osterloh, hereby certify that on June 29, 2018, a true and accurate copy of the foregoing Response to Staff Report was served via electronic mail and postage-paid U.S. mail to the following:

Brian Cumbo
86 W. Main St., STE 100
P.O. Box 1844
Inez, KY 41224
cumbolaw@cumbolaw.com
Counsel for Martin County Water District



Counsel for the MCCC

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