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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 POST-HEARING MEMORANDUM

Pursuant to the Commission's August 21, 2018 Order Martin County Concerned Citizens, Inc. ("MCCC"), by and through counsel, respectfully submits this post-hearing memorandum.

INTRODUCTION

This case is extraordinary in many respects. The Martin County Water District ("Martin District") filed for a nearly 50% rate increase in the midst of a crisis. When this case opened, the Commission received public comments describing the difficulties the Martin District's customers faced living without water in the middle of winter. The Martin District asked for the rate increase at a time when it simply could not serve its customers. For that reason alone, it is understandable that the public is overwhelmingly opposed to any rate increase. On a fundamental level, why should any customer be required to pay more for water service that is unreliable and water that is not potable?

On the other hand, the Commission heard testimony from multiple witnesses that the Martin District was on the verge of complete financial collapse. As the Commission found:

> The record shows that the Martin District's current state is a result of past conduct, including bad business practices and ineffective management and

> leadership, that allowed the facilities required to provide adequate, efficient, and reasonable water service to ratepayers to deteriorate without proper maintenance. That past conduct has left Martin District on the brink of financial insolvency and, in the current state, unable to address even immediate routine repairs.

Order, Mar. 16, 2018, at 7. Immediate funds were needed to stabilize the district's finances enough to ensure that the district continued to operate. On March 16, 2018, the Commission ordered an immediate 17.5% interim rate increase and imposed a $4.91 per customer debt service surcharge.

In addition, just before the January water crisis and rate increase application, a new board took over. MCCC's working relationship with the new board has been good overall. MCCC remains hopeful that the new board's recognition of the scope and depth of the operational and financial deficits of the district, combined with the time and effort the new board members are expending, is the best hope of averting a catastrophic failure of the Martin District that would have severe repercussions for the Martin District's customers and the economic viability of the county as a whole. MCCC is committed to continuing to work with the board.

More than anything, the Martin District needs competent daily management now. The District must prioritize hiring a professional manager who will implement standardized procedures to oversee purchasing and use of overtime and oversee the accounts of the Martin District on a daily business. The new manager must also understand the operational challenges facing the District and lead the effort to develop and systematically implement a plan that will reduce the water loss rate below 15%.

I. MCWD's Reporting Responsibilities

A consistent theme in the public comments the Commission has received in this matter is the lack of trust the Martin District's customers have in the water district. Trust can and must be restored, but that will take time. At a minimum, the Martin District must commit itself to providing respectful and timely responses to each customer complaint. That has not yet happened. MCCC is hopeful that the new general manager will understand the district's burden to rebuild the public trust and will commit to ensuring better customer relations.

But better customer relations are not sufficient to rebuild the public's trust in the district. The Commission must also continue to demand public accounting of the district's finances. MCCC strongly supports the Commission's order that the district "account for every dollar collected." Order, Mar. 16, 2018, at 9. MCCC is troubled that the Martin District has failed to consistently comply with that aspect of the March 16 Order. In particular, the district has missed deadlines for filing its required financial reports and has continued to file accounting reports without narrative explanations that are nearly useless in deciphering the district's monthly financial activities. In addition, based on the testimony of Mr. Kerr at the August 7 hearing, it seems that the district is frustrated with the burden of its reporting requirements. MCCC hopes that the Martin District understands that its request for a rate increase is extraordinary, particularly because it seeks such a large increase at a time when it is unable to provide a safe, reliable source of water for its customers. The request is also extraordinary because the financial woes of the district are caused by years of gross mismanagement of the district's finances and assets. The financial transparency required by the Commission's March 16 Order and the financial reporting that MCCC seeks going forward are critical to rebuilding the trust between the Martin District and its customers.

Going forward, MCCC respectfully requests that the Commission's monthly financial transparency reporting requirements be continued for as long as the Commission's investigation, Case No. 2016-00142, remains open. The monthly financial disclosures can be filed in the investigation case after this rate case is concluded. Further, MCCC respectfully requests that the monthly financial disclosures include a narrative that describes the month's overall expenses, revenues, and write offs, as well as a description of and justification for any unusual monthly financial activities.

II. MCWD's Written Plan of Corrective Action

The March 16, 2018 Order states, "[t]he Commission will eventually, in the Final Order in this case, require Martin District to file a written plan of corrective action." Order, at 9. MCCC strongly supports this requirement. For too long, the Martin District has been in triage mode. Past plans have been ignored, shelved, and forgotten. The district cannot hope to survive without a plan for how to fix the operational, management, and financial problems its faces.

Because of the importance of the corrective action plan, MCCC respectfully asks that no rate increase be given effect until MCCC has had an opportunity to comment on the plan, and the Commission has approved it. Further, the plan should set forth specific operational, financial, and management goals for the district. MCCC suggests that at a minimum, the plan should address the high water loss numbers, problems with the system's raw water intake, problems with the water treatment plant, proper procedures for effective daily oversight of the district's spending, mechanisms for ensuring that the district is using its resources efficiently, and a plan for reducing the district's reliance on Linda Sumpter as a contractor. MCCC respectfully asks that the corrective action plan include concrete deliverables and deadlines for action, like those found in the 2007 Audit. Finally, MCCC asks that the reporting required to ensure follow-through of the plan be submitted in the Commission's investigation of the Martin District, Case Number 2016-00142.

III. MCCC's Position Regarding the Debt Service Surcharge

In its June 29, 2018 response to the Commission staff report, MCCC stated its position that the debt service surcharge imposed by the Commission's March 16, 2018 Order was unlawful. Given the unique circumstances of this matter, MCCC would like to revise its position. Specifically, MCCC will withdraw its objection to the imposition of the debt service surcharge if the Commission orders specific procedures to govern disbursements from the debt service surcharge account that the Martin District has opened.

Specifically, MCCC seeks an order from the Commission that directs the following measures or measures that are substantially similar to the following:

(1) The Martin District must maintain separate accounting for debts accrued prior to April 1, 2018, that is, the debts that can be paid from the surcharge account;
(2) The Martin District must first pay all past debts from vendors that total $1000 or less. In so doing, the Martin District should be encouraged to negotiate with vendors whose balance may exceed the $1000 threshold to accept $1000 as full payment for amounts due prior to April 1, 2018.
(3) For the remaining vendors, the debt shall be paid in monthly disbursements to each vendor on a pro rata basis.
(4) The Martin District shall provide monthly accounting to the Commission on the amount paid to each vendor and the total outstanding balance for each vendor. That accounting can be provided in the Commission's ongoing investigation of the Martin District, Case No. 2016-00142.

MCCC also asks that the Commission's final order in this matter specifically forbid any payment to any vendor for amounts due on or before April 1, 2018 that is not in conformity with the final order of the Commission.

MCCC believes that an order of this type and specificity regarding the use of the debt service surcharge funds will be beneficial to the Martin District by (1) setting forth a specific plan for payment of the past due amounts, (2) ensure that all vendors are paid in fair and equitable manner, (3) relieve the District of the burden of responding to vendors seeking preferential treatment in the payment of past due amounts, and (4) streamline and systematize the Martin District's reporting responsibilities to the Commission.

IV. No Additional Rate Increase Should Be Granted at This Time

MCCC retains the position set forth in its response to the Commission staff report that the 2016 test year is not a reliable indicator of the Martin District's current revenue needs. 2016 should not be relied upon because the expenses are, in many instances, more than two years old, and the numbers are simply stale. Further, the 2016 report has not been audited and therefore has not been independently verified. In addition, based on testimony presented by multiple witnesses throughout this matter, it has become clear that there were few, if any, controls on spending in 2016, and the year's expenses are likely inflated in key respects. Finally, the Martin District is simply not yet stabilized. The district's operations and finances cannot be stabilized until it has a competent General Manager in place. The district's revenue needs cannot be determined until that stabilization has occurred.

For that reason, MCCC reasserts its position that the interim rate increase ordered by the Commission on March 16, 2018 should remain in effect and that no additional rate increase should be granted at this time. MCCC remains hopeful that the operational and financial situation of the Martin District will be stabilized this year. Once the Martin District's situation has stabilized, the Martin District should be encouraged to submit a new application for a rate increase using a more recent test year.

V. In the Alternative, MCCC's Position Regarding Particular Items in the Staff Report and the Martin District's Response.

A. Water Loss

MCCC strongly supports the Commission staff's disallowance of expenses attributable to water loss above 15%. Since the Commission's first investigation of the Martin District in 2002, water loss has been the primary issue facing the District. In intervening years, the problem has only gotten worse.

Compounding the problem of the high rates of water loss, the current water loss reporting is unreliable. The Martin District's water loss reports have been demonstrably unreliable in recent months. The Martin District's response to the unreliability has been to assert that the problem with computing water loss is related to problems with the master meter that reads the water leaving the water treatment plant. The Martin District has been working toward replacing that meter since March 2018, but has yet to do so.

The Martin District's efforts to date to reduce water loss are piecemeal and consist primarily of fixing leaks as they occur. As Mr. Heitzman has explained in testimony in the investigation, fixing a line in one place often causes additional leaks farther downstream because of increased pressure. The Martin District has no way of determining whether any leak it fixes alleviates or worsens the overall water loss problem. Furthermore, the Martin District's hopes to reduce its water loss by replacing service lines in the Beauty and Lovely areas of the county using the Appalachian Regional Commission grant that it has received. However, both Mr. Scott and Mr. Heitzman testified at the hearing on August 8 that there has been no quantification of the extent to which those service line replacements may affect the overall water loss percentages of the district.

Without any capital improvement plan for systematically replacing water lines and without any way of reliably quantifying the amount of water being lost, the Martin District's request for an increase to cover the costs of treating and pumping water that is lost in the system, above the 15% allowed by regulation, must be denied. If the Martin District's board, in consultation with the newly hired General Manager and a professional engineer, approves a specific corrective action plan designed to get the Martin District's water loss rates below 15% in a certain period of time, the Martin District should seek a capital improvements surcharge to fund the plan when it files for its next rate increase.[1] Such a plan should include, at a minimum, a detailed mapping of the Martin District's water lines prioritized by rates of leakage in each area, a prioritization plan for replacing the main and service lines in each area, and estimated costs of replacing the main and services lines in each area.

B. Bad Debt

MCCC believes that the bad debt expense in the 2016 test year expenses is unsubstantiated and should be disallowed. In particular, according to the Martin District's annual reports to the Commission, the 2016 bad debt expense of $67,543 is significantly above the amounts reported for 2015 and 2014, which were $53,516 and $52,402, respectively. In testimony regarding the calculation of that expense, Ms. Sumpter stated that she had not compared the 2016 expense to earlier years. Ms. Miller testified that she normally verified bad debt expenses by looking for adjusting entries and if there were none, the staff would accept the expense as presented. Here, there has been no audit of the test year financials and therefore no adjusting entries. Furthermore, the Martin District is currently in the process of developing new practices for handling its accounts receivable. For these reasons, MCCC believes that the bad debt expense of $67,543 in the 2016 test year cannot be substantiated and the entire amount should be disallowed.

C. Late Fees

During the hearing on August 7, 2018, Ms. Sumpter testified that the 2016 test year expenses included expenses for late fees. Ms. Miller testified that late fees are not typically

[1] The line-loss surcharge implemented by the Commission in the 1996 investigation of the Mountain Water District provides a useful example of the Commission's prior implementation of this particular type of surcharge. *See*, Order, PSC Case No. 96-126, Aug. 11, 1997. In particular, the final Order in that matter included particular surcharge reporting requirements that MCCC would wish to have instituted should a such a surcharge be put into effect. *Id.* at 9.

allowed by the PSC in calculating a district's revenue needs. In its response to MCCC's post-hearing data request, the Martin District provided a "Schedule of Late Fees / Finance Charges 2016." *See Martin District Response*, Ex. 3. The schedule itemizes $6,600.89 in late fees and finance charges for 2016 and provides a caveat that additional charges may have occurred in 2016 that are not accounted for in this exhibit. MCCC agrees that the proper policy is to disallow expenses attributable to late fees or finance charges as a basis for rate making. The Martin District's expenses attributable to late fees or finance charges during the test year were at least $6,600.89. MCCC believes therefore that the 2016 expenses should be reduced by at least $6,600.89.

D. Employee Wages

MCCC objects to the employee wages increase that the Martin District seeks in its response to the Commission's staff report. *See*, MCWD's Response, Jun. 29, 2018. Specifically, based on testimony at the August 7, 2018 hearing, the expense attributable to the yet-to-be-hired General Manager is not known and measurable and therefore cannot be included in the calculation. Neither is the "other vacant employee position." With regard to that position, MCWD stated in its response that it "will be filled once the final rate increase is approved and the District is able to stabilize its finances to pay current expense obligations." *Id.*, at 1. Furthermore, MCCC agrees with the Commission staff that the overtime hours are costs attributable to excessive water loss and should be disallowed. For those reasons, MCCC objects to the increase $63,206 in wages and $2,898 in payroll taxes that the Martin District seeks.

E. Depreciation Expenses

Based on the testimonies of Alan Vilines and Ariel Miller at the August 7, 2018 hearing on this matter, MCCC withdraws its objection to the Martin District's calculation of depreciation expenses. In its June 29, 2018 Response to the staff report, MCCC argued that it appeared that the Martin District's calculation of its depreciation expense was inflated because of the failure to consider the salvage value of depreciating assets. Having heard the testimony of Mr. Vilines and Ms. Miller, MCCC now believes that any salvage value is likely to be minimal and that the Commission's past practice has been to disregard such values. For those reasons, MCCC withdraws this objection.

F. Wholesale Sales

MCCC has no objection to removing wholesale sales of $67,792 from consideration so long as expenses related to water produced and transported for wholesale sales are also removed from consideration, as set forth in the Martin District's response to the Commission staff report. *See* MCWD Resp., Jun. 29, 2018, at 2.

CONCLUSION

For the reasons set forth above, MCCC opposes any additional rate increase above the increases set forth in the Commission's March 16, 2018 Order in this matter. Because of the unique circumstances of this matter, MCCC withdraws its objection to the debt service surcharge so long as the Commission orders specific procedures to govern disbursements from the district's debt service surcharge account. In addition, because of the ongoing need for transparency with regard to the Martin District's operations, MCCC respectfully asks the Commission to require the Martin District to continue to submit monthly financial reports after this matter has concluded. Finally, MCCC strongly supports the Commission's statement that it would require the Martin District to submit a corrective action plan. MCCC respectfully asks for the opportunity to comment on any proposed plan before it is approved and asks that the Martin District be required to provide monthly reports on its progress in meeting the plan's requirements. All future monthly reporting can be submitted in the Commission's investigation, Case Number 2016-00142, after this matter is closed.

Respectfully Submitted,

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CERTIFICATE OF SERVICE

Pursuant to 807 KAR 5:001 Sec. 6, I hereby certify that on August 24, 2018, a true and accurate copy of the foregoing Post-Hearing Memorandum was served via electronic mail and postage-paid U.S. mail to the following:

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