

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF SOUTHERN WATER )  
AND SEWER DISTRICT FOR AN ALTERNATIVE RATE ) CASE NO. 2018-00230  
ADJUSTMENT )

NOTICE OF FILING

Notice is given to all parties that the following materials have been filed into the record of this proceeding:

- The digital video recording of the evidentiary hearing conducted on January 24, 2019 in this proceeding;
- Certification of the accuracy and correctness of the digital video recording;
- All exhibits introduced at the evidentiary hearing conducted on January 24, 2019 in this proceeding;
- A written log listing, *inter alia*, the date and time of where each witness' testimony begins and ends on the digital video recording of the evidentiary hearing conducted on January 24, 2019.

A copy of this Notice, the certification of the digital video record, hearing log, and exhibits have been electronically served upon all persons listed at the end of this Notice.

Parties desiring to view the digital video recording of the hearing may do so at

[https://psc.ky.gov/av\\_Broadcast/2018-00230/2018-00230\\_24Jan19\\_Inter.aspx](https://psc.ky.gov/av_Broadcast/2018-00230/2018-00230_24Jan19_Inter.aspx).

Parties wishing an annotated digital video recording may submit a written request by electronic mail to [pscfilings@ky.gov](mailto:pscfilings@ky.gov). A minimal fee will be assessed for a copy of this recording.

Done at Frankfort, Kentucky, this 22<sup>nd</sup> day of February 2019.



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In the Matter of:

ELECTRONIC APPLICATION OF SOUTHERN	)	CASE NO.
WATER AND SEWER DISTRICT FOR AN	)	2018-00230
ALTERNATIVE RATE ADJUSTMENT	)	


CERTIFICATION

I, KaBrenda L. Warfield, hereby certify that:

1. The attached DVD contains a digital recording of the Hearing conducted in the above-styled proceeding on January 24, 2019. Hearing Log, Exhibit List and Witness List are included with the recording on January 24, 2019.
2. I am responsible for the preparation of the digital recording;
3. The digital recording accurately and correctly depicts the Hearing of January 24, 2019
4. The Hearing Log attached to this Certificate accurately and correctly states the events that occurred at the Hearing of January 24, 2019 and the time at which each occurred.

Signed this 21<sup>st</sup> day of February, 2019.

  
\_\_\_\_\_  
KaBrenda L. Warfield, CKP  
Paralegal Consultant

  
\_\_\_\_\_  
Stephanie Schweighardt, Notary Public  
State at Large  
Commission Expires: January 14, 2023  
ID#: 614400



Date:	Type:	Location:	Department:
1/24/2019	Alternative Rate Adjustment	Hearing Room 1	Hearing Room 1 (HR 1)

Judge: Bob Cicero; Talina Mathews; Michael Schmitt  
 Witness: Terry Fyffe  
 Clerk: KaBrenda Warfield

Event Time	Log Event
8:51:58 AM	Session Started
8:52:00 AM	Session Paused
9:11:31 AM	Session Resumed
9:11:33 AM	Session Paused
9:13:14 AM	Session Resumed
9:13:18 AM	Chairman Schmitt Note: Fields, Angela
	Chairman Schmitt stating Preliminary remarks and introduction of Vice Chairman Cicero and Commissioner Mathews.
9:15:14 AM	Atty Strobo Southern Water and Sewer District Note: Fields, Angela
	Intorduction of attorney and who he represents.
9:15:19 AM	Asst. Atty. Gen. McNeil Note: Fields, Angela
	Intorduction of attorney and who he represents.
9:15:24 AM	Atty. Bowker Public Service Commission Note: Fields, Angela
	Intorduction of attorney and who he represents.
9:15:28 AM	Chairman Schmitt Note: Fields, Angela
	Comments.
9:15:46 AM	Atty. Bowker Public Service Commission Note: Fields, Angela
	Update on where we are at with the briefs.
9:16:11 AM	Chairman Schmitt Note: Fields, Angela
	For the record.
9:16:42 AM	Chairman Schmit - witness Fyffe Note: Fields, Angela
	Swearing in.
9:16:55 AM	Chairman Schmit - witness Fyffe Note: Fields, Angela
	Would you state your name and business address for the record please?
9:17:17 AM	Chairman Schmit - witness Fyffe Note: Fields, Angela
	And you are testifying here today pursuant to a subpoena, is that correct?
9:17:22 AM	Chairman Schmit - witness Fyffe Note: Fields, Angela
	When this case was first heard you were subpoenaed and you contacted Public Service Commission Staff and advised that you had other plans and asked to be excused subject to testify on a later date? Is that correct?
9:17:46 AM	Chairman Schmit - witness Fyffe Note: Fields, Angela
	Let me give you some background information on what we are doing here.
9:19:40 AM	Chairman Schmit - witness Fyffe Note: Fields, Angela
	Have you been the subject to a deposition on a appraisal in other cases?

9:20:39 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Can you tell us for the record something about the education, training, and experience you have which would qualify you to perform an appraisal on certain assets of Southern Water and Sewer District?
9:22:42 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Mr. ? was what? A CPA, a business evaluation expert apparently in Lexington?
9:22:51 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	And I think Mr. Campbell previously testified that, he didn't say who it was, that someone he contacted or who he had been advised could do it, apparently couldn't but then referred him to you. Is that what you understood?
9:23:09 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Your a Certified Public Accountant, is that correct?
9:23:20 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	What does ABV stand for specifically?
9:24:00 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	You worked with and for a few years managed Kelley and Galloway in Ashland
9:24:09 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Was Harold Kelley alive then?
9:24:27 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Can you tell us when you were first contacted?
9:24:46 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Your best estimate please on when you were contacted about doing an appraisal and who contacted you?
9:26:19 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	When you were contacted you believe your best estimate in August of 2018 by Mr. Campbell who was basically General Manager or President of Prestonsburg City Utility Commission, correct?
9:26:41 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	At that point in time were you engaged to perform these services or did you have to meet with Mr. Campbell or an attorney or something in order to work out the arrangements of your appraisal and what you are going to do?
9:27:18 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	And you met with him in Prestonsburg is that correct?
9:27:21 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Did you meet with Mr. Talley at all to get an understanding of what your appraisal entailed?
9:28:30 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	When you met with Mr. Campbell that was in Prestonsburg, was that also in August of 2018?
9:28:42 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	And what did Mr. Campbell tell you that the scope of work the work that you were asked to do would include?
9:30:31 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	At the time that you met with Mr. Campbell the first time to discuss the scope of the work that he or the parties would like for you to do, is that when you were basically taken on a visit to some or all of the assets that were subject to the transfer, or was that a different occasion?
9:40:42 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	You spoke to the auditor, correct?

9:40:46 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Did you understand or come to understand that he had been the person who had audited Southern Water District for six, seven, eight, nine years or better?
9:41:01 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	He provided you with five years worth of audits?
9:41:04 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	The last audit that you saw would have been what 2017?
9:41:11 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	In 2016 or 2015 audit did the auditor ever indicate that he had any concern about the financial strength or liability of Southern Water District?
9:42:10 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	When Southern filed for this rate increase and the year before when the transfer or the proposed transfer was submitted in a separate case for this Commission's consideration. We were I think lead to believe that Southern Water District was in a state of almost financial extremis. To say that it basically its survival from a financial standpoint was six months to a year away at best. Did you see anything in any of the audit records that would indicate that to you?
9:44:39 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	So when you went accompanied by Mr. Campbell to look at certain assets is it fair to say that what you reviewed were water distribution assets somewhere from US 23 to the Pike County line?
9:45:07 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Did you review or look at hard assets at any other location other than that?
9:45:20 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Any other place in Floyd County?
9:45:59 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Did you review any sewer assets?
9:50:10 AM	Vice Chairman Cicero - witness Fyffe Note: Fields, Angela	Is that typical to agree to a zero value between the parties knowing that the assets are kind of tied together?
9:52:31 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	You didn't go see the sewer systems?
9:52:46 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	And Mr. Hall although you requested documents or information concerning the sewer assets those were never provided to you is that correct?
9:53:13 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	What would you have wanted then?
9:53:55 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Mr. Hall never provided anything to you at all is that what you said? Other than the depreciation schedule and the five or six audits.
9:54:05 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	What documentation did Mr. Campbell provide you with if you remember?
9:57:04 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Southern never provided you but Dean Hall never provided you that was some of the information you would have requested from Mr. Hall but wasn't given to you. But you got some of that information from the Public Service Commission Staff Report is that correct?

9:59:32 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Other than the one meeting you had with Mr. Campbell is that the only time you met with Mr. Campbell in person prior to completing your report?
10:01:01 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Did Judge Executive Hale or Mr. Campbell or Dean Hall or anybody indicate if the primary concern of the Judge or Southern was the ? itself of the sewer assets why the water distribution assets became apart of the transaction?
10:02:09 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	You had one conversation with Judge Executive Hale and Dean Hall by telephone. Did you ever speak to either Judge Executive Hale or Dean Hall on any other occasion other than that one time?
10:02:35 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Prior to the time that you issued your report. Were you ever told or otherwise made aware that there was some agreement or understanding that at the time this transaction was finalize that the Floyd County Government the Floyd County Fiscal Court would receive about two million dollars from Prestonsburg Utilities?
10:04:02 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Let me try to sum this up accurately not to put words in your mouth. And tell me if this is not accurate?
10:06:05 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	And this was said to you by Judge Executive Hale in the phone conversation?
10:06:14 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Is he the one who made the phone call to you?
10:06:17 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	And then what? Yall got Dean Hall on the line or was he already in the office?
10:06:39 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Did Judge Executive Hale or Dean Hall or anybody else ever tell you that in 2012 the KentuckyPublic Service Commission had held that Southern Water and Sewer District could not recover any payments made to Floyd County on this two million dollar bond payment that the Floyd Fiscal Court had previously undertaken on the district's behalf because it was not obligated to do so?
10:07:21 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Did Judge Hale or Dean Hall or anybody else ever tell you that the Office of the Kentucky Attorney General had issued an opinion stating that the Southern Water District did not owe and that Floyd County Fiscal Court or Government was not entitled to receive money that was otherwise owned by the Southern Water District in repayment or partial payment towards a previous bond issue?
10:07:52 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	But it is your understanding that ultimately about four million dollars would be paid by Prestonsburg City Utility Commission for the assets that were to be transfered by Southern Water Sewer District to Prestonsburg Utilities?
10:08:44 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Did you understand that at the time you were contacted that Prestonsburg City Utility Commission had already made some substantial payments to Southern Water and Sewer District or on its behalf paying for loan reduction and providing equipment and sofourth?



10:09:30 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	When the initial case was filed in 2017 and this Commission approved it. Let me make this statement and then I'll ask you a question or two about it.
10:10:26 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Were you aware of that?
10:10:51 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	When we approved the sale we understood that the total consideration was going to be \$2,140,000.00 and were told by both parties this was an arm's-length transaction.
10:11:06 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Assuming that is true that value would not be correct? That would not represent in your opinion as to the true value of the assets transferred or to be transferred, is that correct?
10:11:21 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	That proposed payment would be about one half of the actual true value of the assets that were to be transferred, is that correct?
10:11:49 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	You've indicated that you had at least three types of documentation so far. One was the initial engagement letter between you or your firm and Prestonsburg Utility or both but Prestonsburg was the contact, and then you provided a list of documentation or information that you would like to have from Prestonsburg and Southern, and then three you referenced that you have email correspondence between Mr. Campbell and Prestonsburg and also Jude Executive Hale for a time and Dean Hall would you mind providing that information to the Commission?
10:14:02 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Is it fair to say that based on all the information that your final opinion is represented by your business valuation of Southern Water and Sewer District as of June 28th but it is dated October 31, 2018.
10:14:30 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	That essentially that included all of the assets transferred or to be transferred which was the water distribution assets and the sewer assets correct?
10:14:43 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	But the sewer assets were essentially valued out at zero based on discussions with the parties and general inability to have additional information that you might of wanted. Is that correct?
10:15:17 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	What would you have advised a client exercising reasonable and prudent business judgement to have done?
10:16:28 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Why?
10:16:42 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	In fact it would be unreasonable and show a lack of business judgement and acumen to basically execute letters of intent intent documents transfer documents to go forward with this deal without having done that in advance. Would you agree with that?
10:17:43 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	I noticed in your report you indicated some document that had been prepared by Kentucky American Water or American Water Works or something. What was that?

10:24:36 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Dean Hall testified at the previous hearing and I guess it was my understanding that they had some type of contact with Kentucky American or the parent company...
10:25:06 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	And I didn't know if you had gotten any information from them at all?
10:25:28 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	I noticed in your report you indicated there were no comparable sales of utilities or public utilities that you were able to use?
10:26:15 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Do you understand that as of today that the US Department of Agriculture has not approved this transfer of assets clear of its liens?
10:26:36 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Have you been told why? Have you spoken to anybody at USDA?
10:26:41 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	None of them have called you to talk about your appraisal or anything you did?
10:26:47 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	What about Kentucky Infrastructure Authority?
10:26:59 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	But I was just wondering if you had spoken to them or if they had had any contact with you at all?
10:27:54 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Mr. Campbell's (Eddie Campbell) estimate is not far from your estimate correct?
10:28:47 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Did Mr. Campbell ever tell you prior to the time that you arrived at your appraisal figure what his idea of the value was?
10:30:06 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	I guess that's right when you're, you're put in a spot when your doing an appraisal and both parties are relying on it.
10:30:50 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	When you sent the report it is addressed to Dean Hall, it doesn't mention Prestonsburg City Utilities or Mr. Campbell can you tell me why?
10:31:33 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	But Mr. Campbell and Prestonsburg City Utility Commission would have gotten a copy of the report at the same time?
10:31:50 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Was anyone else sent a copy of the report?
10:32:05 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Can you tell us what your total fees were? What did you charge for your report?
10:32:27 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Can you tell us what your charge would be?
10:32:50 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Is it your understanding that Prestonsburg is going to pay you for your expenses and fees for appearing here and testifying today?
10:33:03 AM	Chairman Schmitt - witness Fyffe Note: Fields, Angela	Ten Minute Break
10:33:15 AM	Session Paused	
10:47:54 AM	Session Resumed	

10:47:55 AM Chairman Schmitt - witness Fyffe  
Note: Fields, Angela We're back on the record. I have no further questions.

10:48:09 AM Chairman Schmitt  
Note: Fields, Angela Vice Chairman Cicero questions?

10:48:30 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela When I look at the report that was issued.

10:48:54 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela I'm curious why there wouldn't be some indication on here that there was a representation to both parties?

10:50:54 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela Did Mr. Campbell contact you and request the appraisal or did Mr. Hall contact you and request the appraisal?

10:51:36 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela I'm just clarifying why the appraiser report is the subject of a lot of scrutiny.

10:52:42 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela In this appraisal of 4.1 million dollars what does it represent?

10:53:01 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela Inclusive of sewer and anything else that's associated with the water assets?

10:53:09 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela 4.1 million in total?

10:53:14 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela RD did not contact you to question the appraisal or check its validity or what your understanding of what was transferred?

10:53:40 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela That's the basis for this appraisal is that correct?

10:54:11 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela So when the initial transfer was requested from the Public Service Commission I questioned the value being paid for the assets.

10:55:33 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela Can you tell us if that is a written document you viewed?

10:55:50 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela So we do not have a copy of that additional agreement, that is correct.

10:56:11 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela When you prepare your report you talk about a five year projection of lost revenue based on management, assumptionest, due to the companies future outlook.

10:56:22 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela You weren't able to obtain any assumptions from Southern is that correct?

10:57:01 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela Did they indicate to you when they talked about the sewer assets that when you reached a transfer value of zero because it had a negative income impact correct?

10:57:48 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela So this is where I become a little confused.

10:58:08 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela I don't know if you knew what that was or not?

10:58:17 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela So they never provided that?

10:58:20 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela So when you do a industry specific or a company specific cap factor. Knowing that the water assets couldn't be transfered without the sewer assets it was a whole package and it had to be taken together?

11:00:35 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela Being an accountant and looking at debts and credits and looking at the water district as being a debt and the sewer assets being an offset to that. But none of that was applied looking at the total appraisal to see together what that value would be?

11:01:24 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela You made the statement that the parties agreed that it would be zero.

11:03:51 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela So Prestonsburg agreed with the zero valuation of the sewer assets and the fact that there was no negative revenue impact for the total valuation?

11:04:22 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela In other words to meet the valuation deadline you thought that time was of the essence because of the RD pressure to come up with an appraisal?

11:04:56 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela Who conveyed that to you?

11:05:05 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela Okay so Mr. Campbell told you [click on link for comments].

11:06:07 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela Did you ever go back to Mr. Hall and say what you are providing is inadequate and I need more information?

11:06:26 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela How many utilities have you appraised in the past?

11:06:57 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela So it's been a while?

11:06:59 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela And if i understood you took a drive around the area in question to view who the customers were basically?

11:07:51 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela So when I look at national economic and industry conditions in your report or oil and gas prices and jobs that's just kind of a filler for your report?

11:08:57 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela But you mention 25% for coal for treasury bonds 4% and somewhere between there comes everybody else.

11:10:20 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela Do you have a copy of your repor with you?

11:10:39 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela I am looking at your historical and normalized financial statements.

11:10:54 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela So when you look at historical and you took the \$656,122.00 from a PSC Staff Report rightt?

11:11:06 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela So how do you back fill back to 2013 with the same revenue stream?

11:12:09 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela Although in this case we do not know?

11:12:41 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela One comment on the \$656,122.00.

11:13:03 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela So what if I told you the \$656,122 that you are using for this valuation is basically one month of actual extrapolated out to twelve months annualized because they had difficulty with Southern's analysis of billing as well?

11:13:46 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela Actually Southern provided a number that could not be substantiated because they did their own billing analysis and when they did do the billing analysis it did not match.

11:15:00 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela Can you go to page six billing analysis adjustment.

11:15:44 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela Then did read to B?

11:16:05 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela Can you read the third sentence down on that B?

11:17:08 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela Can you read sentence three of B on page six?

11:17:32 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela So that was for the twelve months, am I right?

11:18:29 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela I'm not being critical of you for using the number you did given the circumstances that you couldn't get a number from Southern. [Click on link for comments.]

11:19:01 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela Some of the assumptions may not be the best assumptions to be used?

11:20:57 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela I'm only bringing this up because I'm looking at the historical and the normalized financial statements. And I know so much rest on the 2017 numbers.

11:21:19 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela So if I go to the third page after the historical and financial data. Which you are looking at equity value comparisons.

11:22:06 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela Or is that the discounted revenue stream that you have done here?

11:23:22 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela So if I look at it the future values come up to 2,280,530 right?

11:24:10 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela Just so I understand the 482,906 projected equity net cash flows the first column is the 656,122 discounted back?

11:25:23 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela I'm just trying to understand for my own purposes.

11:25:35 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela I just don't understand why that number stays constant through all five years?

11:26:23 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela So these are not related in other words is what you are saying?

11:27:28 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela Well understanding that none of these numbers are not going to tie together because you don't have them in a computer program is what you are saying?

11:28:04 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela So then when I get back to the appendix perfection of assumptions.

11:28:18 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela So this page is just redundancy right?

11:29:21 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela Because if you go to the next page [click on link for comments].

11:30:07 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela So on behalf of both entities there was three goals or objectives right?

11:30:15 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela The last two was one was the stability of Southern post transaction and the other was the stability of Prestonsburg post transaction.

11:30:30 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela In viewing the financials do you think that this transaction affected the stability of either Prestonsburg Southern or Both? Negatively I meant.

11:33:33 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela You didn't really include that statement in your report tho right?

11:36:00 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela When did you say you found out that two million dollars of the transaction was to go to the fiscal court rather than Southern?

11:36:38 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela So you really didn't know?

11:36:43 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela I think that is one of the large negative impacts is the fact that two million that might have gone to pay off debt or help the district financially was really going to the fiscal court?

11:37:15 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela And that number was earmarked by the Floyd County Fiscal Court possibly to go to them?

11:37:40 AM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela I think that is all I have.

11:37:43 AM Chairman Schmitt  
Note: Fields, Angela Mr. Bowker questions?

11:37:46 AM Atty. Bowker Public Service Commission - witness Fyffe  
Note: Fields, Angela I have two follow up questions please.

11:37:52 AM Atty. Bowker Public Service Commission - witness Fyffe  
Note: Fields, Angela Did you examine at any time any of the annual reports filed with the Public Service Commission for the sewer assets that would of included Southern District's revenue stream on the sewer?

11:38:08 AM Atty. Bowker Public Service Commission - witness Fyffe  
Note: Fields, Angela Did the audit report you reviewed have water and sewer operations separated?

11:38:16 AM Atty. Bowker Public Service Commission - witness Fyffe  
Note: Fields, Angela That's all I got for you sir. Thank you.

11:38:19 AM Chairman Schmitt  
Note: Fields, Angela Mr. McNeil questions?

11:38:20 AM Asst. Atty Gen. McNeill - witness Fyffe  
Note: Fields, Angela I have no questions left.

11:38:25 AM Atty Strobo Southern Water and Sewer District - witness Fyffe  
Note: Fields, Angela There is no signed engagement letter no signed agreement with Southern Water with your firm correct?

11:38:42 AM Atty Strobo Southern Water and Sewer District - witness Fyffe  
Note: Fields, Angela When was the first conversation you had with Mr. Hall or anybody else at Southern?

11:39:20 AM Atty Strobo Southern Water and Sewer District - witness Fyffe  
Note: Fields, Angela Do your engagement letters say that?

11:39:54 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	Do you think it is important in hindsight that Southern should have signed an engagement letter with you?
11:40:28 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	So even though somebody else is paying you, but you're doing the work for another entity the ones that not paying you, you never require an engagement letter from the entity that is not paying you?
11:41:03 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	But in this case, who do you think you are working for in this case?
11:41:12 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	Okay, and who told you that?
11:41:15 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	Did Mr. Hall ever tell you that?
11:41:30 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	About when was that engagement letter signed?
11:41:42 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	And when did you drive down to visit with Mr. Campbell?
11:42:02 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	About?
11:42:07 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	So one or two days after you signed the engagement letter?
11:42:18 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	When did he call you?
11:42:24 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	After you signed the engagement letter?
11:43:06 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	Was Mr. Hall ever involved with the arrangements for you to come down for that first visit?
11:43:25 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	You were aware that Mr. Hall was supposed to be involved with this engagement when you went down?
11:43:38 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	And was that the only time you came down?
11:43:42 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	When did you receive that phone call from Mr. Hall and the Judge Executive?
11:44:36 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	To the best of your knowledge was the reason for that call the lack of communication with Mr. Hall from your firm?
11:45:40 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	Is it your understanding that Mr. Hall was your client but not the Judge Executive?
11:45:54 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	But you directed your report and cover letter to Mr. Hall?
11:46:10 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	I'm just a little confused. Because this report is directed to Southern and you are using Southern's information to prepare your report but they are not your client?
11:46:30 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	I thought you just said that Southern Water was not the client?
11:47:00 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	Was there any discussion with Mr. Hall about whether or not Southern would pay for some of your services?

11:47:09 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	So you assumed that they wouldn't pay it because Prestonsburg said they would?
11:47:20 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	Who ordered Mr. Campbell to pay for it?
11:47:32 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	How many times did you talk to Mr. Hall on the phone total?
11:47:46 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	Did you ever do a site visit or ever visit Southern's office?
11:47:51 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	Do you typically visit the offices of the entity that you are appraising?
11:48:03 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	Do you ever review the business records of an entity?
11:48:12 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	Do you typically gather those yourself or do you rely on your client to give you those or both?
11:48:19 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	So you don't actually go into the office and look through the records yourself or have an assistant do it for you ever?
11:49:10 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	Did you visit Prestonsburg's office?
11:49:18 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	Just to meet there and then you went out?
11:49:20 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	I assume that you talked about this project while you were at Mr. Campbell's office Correct? And Mr. Hall was not apart of those conversations correct?
11:49:33 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	Have you ever met Mr. Hall in person?
11:49:41 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	And only one phone call correct?
11:49:42 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	About how many time did you all exchange emails?
11:50:48 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	And that's total with Mr. Hall's name on it?
11:50:53 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	And typically Mr. Hall would respond when you asked him for a response?
11:51:32 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	Did Mr. Hall ever express any type of confusion over what you were requesting of him?
11:51:40 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	Did Mr. Hall ever express confusion about who was to give you that information?
11:52:25 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	You submitted your report I think October 31, 2018. Did you give any warning to Mr. Hall that you would be submitting that report on that date?
11:52:51 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	Was there outstanding request still from Mr. Hall that he was supposed to get to you at the time you submitted this report?
11:54:06 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	Did you ever tell Mr. Hall that you were going to use that number from the PSC report?



11:54:29 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	Do you typically submit your report without giving any warning to a client?
11:55:10 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	Did you tell Mr. Hall that you were going to submit the report on the date that you did, prior to submitting that report?
11:55:18 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	Do you typically allow your clients to take a look at the report before you finalize it?
11:56:19 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	After you submitted the report did you receive any feedback from Mr. Campbell?
11:56:37 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	Did you receive any feedback from Mr. Hall?
11:56:39 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	If you were to receive some feedback would you go back and look at your report to make sure whatever feedback they had was accurate or make sure you did what you were supposed to do?
11:57:19 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	Do clients typically respond to your emails immediately?
11:57:48 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	Do you ever have to nag your clients to send you things?
11:58:04 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	Did you review the asset purchase agreement that was signed back in 2017? Did you review all of the exhibits attached to it?
11:58:35 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	You made no independent analysis on your own about the value of the sewer assets correct?
11:58:43 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	And you relied on your clients for that number?
11:58:50 AM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	I'm going to read you something. This is from a resolution adopted by the City of Prestonsburg and it is attached to that asset purchase agreement exhibit 6 and I am going to read it to you.
12:01:28 PM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	How would you evaluate that from an appraisal perspective and how would that impact the appraisal of the sewer assets?
12:01:38 PM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	Tell me why?
12:03:37 PM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	You never had that conversation with Mr. Hall did you?
12:03:41 PM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	You never had that conversation with Mr. Campbell did you?
12:04:18 PM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	I don't want to put words in your mouth, but it sounds like you had an ill feeling about that conversation?
12:04:53 PM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	Did you make it clear in that conversation that your client was Mr. Hall and not Judge Executive Hale?
12:05:42 PM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	You testified previously that you performed two different utility appraisals correct? One was Southshore and what was the other?
12:06:13 PM	Atty Strobo Southern Water and Sewer District - witness Fyffe Note: Fields, Angela	So you've had experience with two different water company type appraisals?

12:06:27 PM Atty Strobo Southern Water and Sewer District - witness Fyffe  
Note: Fields, Angela Do you have any experience appraising a sewer district itself?

12:06:34 PM Atty Strobo Southern Water and Sewer District - witness Fyffe  
Note: Fields, Angela Or sewer assets?

12:06:38 PM Atty Strobo Southern Water and Sewer District - witness Fyffe  
Note: Fields, Angela It sounded like you may have consulted with Mr. Cranfield at some point in your work for Southern and Prestonsburg?

12:07:13 PM Atty Strobo Southern Water and Sewer District - witness Fyffe  
Note: Fields, Angela Did Mr. Cranfield review your report before you submitted it?

12:07:17 PM Atty Strobo Southern Water and Sewer District - witness Fyffe  
Note: Fields, Angela Besides the help that you just described did he help you in any other way?

12:07:23 PM Atty Strobo Southern Water and Sewer District - witness Fyffe  
Note: Fields, Angela Did anybody else in your office assist you with this report?

12:07:54 PM Atty Strobo Southern Water and Sewer District - witness Fyffe  
Note: Fields, Angela To the best of your ability can you describe some of the information that you requested from Mr. Hall that you did not receive?

12:10:03 PM Atty Strobo Southern Water and Sewer District - witness Fyffe  
Note: Fields, Angela Ultimately tho you had information you needed to produce the report that you produced correct?

12:10:12 PM Atty Strobo Southern Water and Sewer District - witness Fyffe  
Note: Fields, Angela Were you aware that Southern had that information as early as July of 2018 in document form and they could have emailed it to you very quickly?

12:10:26 PM Atty Strobo Southern Water and Sewer District - witness Fyffe  
Note: Fields, Angela That's apart of the rate case. And that's PSC's Staff Report was based on the application that Southern submitted to the PSC and your saying the number that was provided there that the PSC approved of that's what you needed to ultimately finish your report correct?

12:10:47 PM Atty Strobo Southern Water and Sewer District - witness Fyffe  
Note: Fields, Angela So that's where I go back to my confusion question as to Mr. Hall not knowing exactly what he needed from you because they had that number for the past six months?

12:11:52 PM Atty Strobo Southern Water and Sewer District - witness Fyffe  
Note: Fields, Angela Could it be possible that Mr. Hall was relying on Mr. Campbell to provide that to you in the first place?

12:12:03 PM Atty Strobo Southern Water and Sewer District - witness Fyffe  
Note: Fields, Angela Why is that?

12:12:47 PM Atty Strobo Southern Water and Sewer District - witness Fyffe  
Note: Fields, Angela So you have two different numbers but you are relying on the PSC number not the Prestonsburg number?

12:13:36 PM Atty Strobo Southern Water and Sewer District - witness Fyffe  
Note: Fields, Angela There seems like there is an inherent conflict here between you representing both Prestonsburg and Southern at the same time.

12:15:07 PM Atty Strobo Southern Water and Sewer District - witness Fyffe  
Note: Fields, Angela Going beyond that number the entire relationship it seems confusing.

12:15:32 PM Atty Strobo Southern Water and Sewer District - witness Fyffe  
Note: Fields, Angela I just want your opinion on why you thought that was okay to represent both entities at the same time on something like this?

12:17:15 PM Atty Strobo Southern Water and Sewer District - witness Fyffe  
Note: Fields, Angela You mentioned just then that you had contracted with Southern but you never in fact had a contract with Southern?

12:18:02 PM Atty Strobo Southern Water and Sewer District - witness Fyffe  
Note: Fields, Angela You mentioned there was a type of urgency associated with getting this report out. Where was that urgency coming from?

12:19:23 PM Atty Strobo Southern Water and Sewer District - witness Fyffe  
Note: Fields, Angela But going back to my question about urgency who conveyed that urgency to you?

12:19:27 PM Atty Strobo Southern Water and Sewer District - witness Fyffe  
Note: Fields, Angela So Mr. Hall never conveyed any urgency to you?

12:19:31 PM Atty Strobo Southern Water and Sewer District - witness Fyffe  
Note: Fields, Angela So is it reasonable to think that Mr. Hall wasn't getting you the information you needed so quickly, because he didn't have that same sense of urgency that Mr. Campbell and you had?

12:20:29 PM Atty Strobo Southern Water and Sewer District - witness Fyffe  
Note: Fields, Angela Thank you sir, no further questions.

12:20:32 PM Chairman Schmitt  
Note: Fields, Angela I just have a couple.

12:20:34 PM Chairman Schmitt - witness Fyffe  
Note: Fields, Angela Did you ever have any conversation or communication either email telephone personal meetings with any of the members of the Commission. The Commissioner of the Southern Water and Sewer District let me read you their names.

12:21:15 PM Chairman Schmitt - witness Fyffe  
Note: Fields, Angela Have you had any communication with any of those people?

12:21:31 PM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela I have just have one comment and two questions. With regard to representing two parties.

12:22:14 PM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela Did anyone or Mr. Hall object to you performing the appraisal?

12:22:34 PM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela Did anyone call or object to you performing the appraisal and what the appraised value turned out to be?

12:23:17 PM Vice Chairman Cicero - witness Fyffe  
Note: Fields, Angela That's all I have.

12:23:24 PM Chairman Schmitt - witness Fyffe  
Note: Fields, Angela Is there any reason why Mr. Fyffe can't be excused?

12:24:04 PM Chairman Schmitt  
Note: Fields, Angela Mr. Strobo do you have any witnesses or anybody to put on or want to call?

12:24:12 PM Chairman Schmitt  
Note: Fields, Angela Mr. McNeil?

12:24:14 PM Chairman Schmitt  
Note: Fields, Angela Staff?

12:24:15 PM Chairman Schmitt  
Note: Fields, Angela Mr. Strobo you have a reply brief left?

12:24:35 PM Chairman Schmitt  
Note: Fields, Angela Remarks about where this case is going. Two Things.

12:25:04 PM Chairman Schmitt  
Note: Fields, Angela One. There should of been a Data Request that ask I guess Southern to see if you can get Fiscal Court minutes from November and December.

12:26:45 PM Chairman Schmitt  
Note: Fields, Angela The other thing is this. I would like to know who your client is?

12:26:57 PM Chairman Schmitt  
Note: Fields, Angela Your client is not the Commissioners individually or Mr. Hall?

12:27:05 PM	Chairman Schmitt Note: Fields, Angela	At some point and time I think they need to know that.
12:27:18 PM	Chairman Schmitt Note: Fields, Angela	Alright is there anything else that anyone would like to say? If not then this hearing will be adjourned?
12:27:30 PM	Session Paused	
12:30:02 PM	Session Ended	



## Exhibit List Report

2018-00230 24JAN2019

**SOUTHERN WATER AND SEWER  
DISTRICT**

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**Name:****Description:**

PSC Exhibit 01

Business Valuation of Southern Water and Sewer District

PSC Handout 01

Notice of Filing of Commission Staff Report

**Business Valuation of  
Southern Water and Sewer District  
As of June 28, 2018**

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***Prepared for:***

Dean Hall  
President  
Southern Water and Sewer  
245 Kentucky Rt 680  
McDowell, WV 41647  
United States

***Report Date:***

10/31/2018

***Prepared by:***

Terry R. Fyffe CPA, ABV  
President  
The Fyffe Jones Group  
2155 Carter Avenue  
Ashland, Kentucky 41105-2245  
United States

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10/31/2018

Dean Hall  
President  
Southern Water and Sewer  
245 Kentucky Rt 680  
McDowell, WV 41647  
United States

**RE: Southern Water and Sewer District**

Dear Dean Hall:

At your request, we have performed a valuation engagement, as defined in the Statement on Standards for Valuation Services (SSVS) of the American Institute of Certified Public Accountants. The valuation is for lost revenues of Southern Water and Sewer District's as of June 28, 2018. This valuation was performed solely to assist in the matter of Support Existing Sale and Transfer and the resulting estimate of value should not be used for any other purpose or by any other party for any purpose. This valuation engagement was conducted in accordance with the SSVS. The estimate of value that results from a valuation engagement is expressed as a conclusion of value.

We have estimated the Fair Market Value on a controlling interest, marketable basis for lost revenues of Southern Water and Sewer District's as of June 28, 2018 as described within the valuation report.

Our conclusion is \$4,020,000 as summarized below. This conclusion is subject to the Statement of Assumptions and Limiting Conditions and the Representations presented in the following report. We have no obligation to update this report or our conclusion of value for information that comes to our attention after the date of this report.

In arriving at this opinion of value, we relied on a "value in use" or going-concern premise. This premise assumes that the Company is an ongoing business enterprise with management operating in a rational way with a goal of maximizing entity value.

As part of this report, we were also asked to opine on the viability of both Southern Water and Sewer District and Prestonsburg City's Utilities Commission after the transfer. See opinion at the end of this report.

Respectfully,

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(Signature)

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(Date)

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# Valuation Objective and Summary

## Assignment Objective

We were engaged by Dean Hall, President, Southern Water and Sewer, to issue a detailed report. Our objective was to estimate the Fair Market Value of lost revenues due to a transfer of customer accounts and related assets of Southern Water and Sewer District's system as of June 28, 2018.

## Company Description

Southern Water and Sewer District is a Non-Profit and is organized under the laws of Kentucky. It is primarily engaged in the business of Water Distribution and is doing business as Southern Water District.

## Qualifications of Appraiser

This report was prepared by Terry R. Fyffe President of The Fyffe Jones Group. Terry R. Fyffe holds the following professional designations and certifications: CPA, ABV.

## Purpose of Valuation

The purpose of this valuation is Support Existing Sale and Transfer of customer accounts and related assets. This report is prepared for Dean Hall President Southern Water and Sewer and should not be used by others without his consent. This report is dated 10/31/2018.

## Standard of Value

The standard of value used in our valuation of Southern Water and Sewer District is *Fair Market Value*. Fair Market Value is defined in IRS Revenue Ruling 59-60 as: "The price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts. Court decisions frequently state in addition that the hypothetical buyer and seller are assumed to be able, as well as willing, to trade and to be well informed about the property and concerning the market for such property."

## Premise of Value

Our opinion of value relied on a "value in use" or going-concern premise. This premise assumes that the Company is an ongoing business enterprise with management operating in a rational way with a goal of maximizing shareholder value.

## Scope of Work

Our analysis considers those facts and circumstances present at the Company at the Valuation Date. Our opinion would most likely be different if another Valuation Date was used. There were no restrictions or limitations in the scope of our work or in the data available for analysis, and no hypothetical assumptions were used.

The factors we considered include the history of the business, economic outlook, financial condition of the business, earnings and dividend paying capacity, book value of the stock and the size of the block being valued, prior sales of the Company's stock, goodwill and intangible value, and the market prices for publicly traded and privately held companies in the same or similar line of business.

## Valuation Procedures

To arrive at our conclusion of value, we performed the following procedures:

- \* Identified the nature of the business and reviewed the history of the Company since its inception.
- \* Researched the general economic outlook and the outlook for the specific industry at the date of the valuation.
- \* Collected the Company's relevant historic financial statements.
- \* Assisted management in preparing a 5 year projection of the lost revenue based on management's assumptions as to the Company's future outlook.
- \* Developed risk-adjusted Capitalization and Discount Rates to apply to the Company's historic and projected earnings, respectively.
- \* In reaching the conclusion of value, we considered the Asset, Income, and Market valuation approaches and the following methods under each approach.
  1. Asset Approach  
Net Asset Value.
  2. Income Approach  
Discounted Future Earnings/Discounted Cash Flow.
  3. Market Approach  
No comparable data was available.
- \* Selected the most reasonable enterprise-level equity value from the range of values established in the valuation methods
- \* Applied any appropriate enterprise-level discounts and/or premiums to arrive at an enterprise-level equity value.

## External Sources of Information

To aid us in our analysis of the Company, we consulted a number of publicly available sources of information. Numerous financial publications and databases were consulted including *Business Statistics*, Standard & Poor's *Industry Surveys*, Ibbotson Associates' *Stocks, Bonds, Bills and Inflation 200X Yearbook*, *Mergerstat Review*, *U.S. Financial Data*, Standard & Poor's *Register of Corporations, Directors, and Executives*, Disclosure, Inc. on-line database, and *Value Line Investment Survey*.

## Internal Sources of Information

To aid us in our analysis of the Company, we interviewed and obtained the following:

1. Site Visit with Eddie Campbell.
2. Kentucky Public Service Commission report on the rate increase filing by Southern.
3. Various Return on Equity including Kentucky American Water Company summary.
4. Telephone conversation with Floyd County Judge Executive Ben Hale.
5. Telephone conversation with Southern Water President Dean Hall.
6. Financial Statements from Prestonsburg City Utilities.
7. Lost revenues and related costs from the PSC report..
8. Lost revenues and related costs estimates from Prestonsburg City Utilities.

## Assumptions and Limiting Conditions

This valuation is subject to the following assumptions and limiting conditions:

1. Public, industry, statistical, and other information furnished by others, upon which all or portions of this analysis is based, is believed to be reliable. However, we make no representation as to the accuracy or completeness of such information and have performed no procedures to corroborate the information.
2. The Company and its representatives warranted to us that the information they supplied was complete and accurate to the best of their knowledge and that the financial statement information reflects the Company's results of operations and financial and business condition in accordance with generally accepted accounting principles, unless otherwise noted. The financial statements and other related information supplied by management has been accepted as correct without further verification. We have not audited, reviewed, or compiled the financial information provided to us and, accordingly, we express no audit opinion or any other form of assurance on this information.
3. This report and conclusion of value is restricted to the internal use of the management of the Company for the sole and specific purpose as noted herein, and shall not be used to obtain credit or for any other purpose or by any other party for any purpose. Neither our work product nor any portions thereof, including any conclusions or the identity of our firm, any individuals signing or associated with this report, or the professional associations or organizations with which they are affiliated, shall be disseminated to third parties other than the Company, its financial accounting firm and attorneys, and governmental agencies by any means without our prior written consent and approval.
4. We or any individual associated with this assignment are not required to provide future services regarding the subject matter of this report, including but not limited to providing further consultation, providing testimony, or appearing in court or other legal proceedings unless specific arrangements have been made.
5. The conclusion of value is valid only for the stated purpose as of the valuation date indicated. We take no responsibility for changes in market conditions and assume no obligation to revise our conclusion of value to reflect events or conditions which occur subsequent to the valuation date.
6. Full compliance by the Company with all applicable federal, state, and local zoning and use, occupancy, environmental, and similar laws and regulations is assumed, unless otherwise stated. Furthermore, no effort has been made to determine the possible effect, if any, on the Company due to future Federal, state, or local legislation including any environmental or ecological matters or interpretations thereof, unless otherwise stated.
7. This report and the conclusion of value arrived at herein are not intended by the author and should not be construed by the reader to be investment advice in any manner whatsoever. The conclusion of value represents the considered opinion of The Fyffe Jones Group based on information furnished to them by the Company and other sources.
8. We do not provide assurance on the achievability of the results forecasted by the Company because events and circumstances frequently do not occur as expected; differences between actual and expected results may be material; and achievement of the forecasted results is dependent on actions, plans, and assumptions of management.
9. For the prospective financial information approved by management that was used in our engagement, we have not examined or compiled the prospective financial information and therefore, do not express an

audit opinion or any other form of assurance on the prospective financial information or the related assumptions. Events and circumstances frequently do not occur as expected and there will usually be differences between prospective financial information and actual results, and those differences may be material.

10. We are not environmental consultants or auditors, and we take no responsibility for any actual or potential environmental liabilities. Any person entitled to rely on this report, wishing to know whether such liabilities exist, or the scope and their effect on the value of the property, is encouraged to obtain a professional environmental assessment. We do not conduct or provide environmental assessments and have not performed one for the subject property.
11. We have not determined independently whether the Company is subject to any present or future liability relating to environmental matters, including but not limited to CERCLA/Superfund liability, nor the scope of any such liabilities. Our valuation takes no such liabilities into account, except as they have been reported to us by the Company or by an environmental consultant working for the Company, and then only to the extent that the liability was reported to us in an actual or estimated dollar amount. Such matters, if any, are noted in the report. To the extent such information has been reported to us, we relied on it without verification and offer no warranty or representation as to its accuracy or completeness.
12. Except as noted, we have relied on the representations of the owners, management, and other third parties concerning the value and useful condition of all equipment, real estate, and any other assets or liabilities, except as specifically stated to the contrary in this report. We have not attempted to confirm whether all assets of the business are free and clear of liens and encumbrances or that the Company has good title to all assets.
13. Neither all nor any part of the contents of this report (including the conclusion of value, the identity of any valuation specialist(s), the firm with which such valuation specialists are connected, or any reference to any of their professional designations) should be disseminated to the public through advertising media, public relations, news media, sales media, mail, direct transmittal, or any other means of communication without our prior written consent and approval.
14. We have not made a specific compliance survey or analysis of the subject property to determine whether it is subject to, or in compliance with, the American Disabilities Act of 1990, and this valuation does not consider the effect, if any, of noncompliance.
15. No change of any item in this valuation report shall be made by anyone other than , and we shall have no responsibility for any such unauthorized change.
16. We have not conducted interviews with the current management of the Company concerning the past, present, and future operating results of the Company.
17. This conclusion of value assumes that the Company will continue to operate as a going concern, and that the character and integrity of the Company through any sale, reorganization, exchange, or diminution of the owners' participation would not be materially or significantly changed. It also assumes that the current level of management expertise and effectiveness would continue to be maintained.

# Company Background

## Company Identification

Southern Water and Sewer District is a Non-Profit organized under the laws of Kentucky and located at 245 Kentucky Rt 680, McDowell, KY, 41647.

## Nature and History of the Company

Southern Water and Sewer District was established in 1999 and operates under the trade name of Southern District.

The following table describes the business activities in which Southern Water and Sewer District is engaged:

<u>Business Activity</u>	<u>Description</u>
Primary Business Activity	Water Distribution
Secondary Business Activity	Sewer Treatment

## Governmental or Regulatory Environment

The District is subject to the Kentucky Public Service Commission. A rate increase was requested to replace the lost revenue from the transfer of certain customers and associated assets to Prestonsburg City Utilities by contract effective June 28, 2018. The PSC approved the rate increase for more than what Southern Water had applied for. The PSC performed a two tier approach in arriving at their decision, and our valuation utilized the detailed info prepared by them.

## Business Risks

The District has additional risks associated with aged lines and sewer treatment plant. Regulatory pressures have been assessed to improve both. Therefore, additional risk assessments have been made in building the Cost of Capital and Discount Rate.

## Current Operations

This valuation only includes specific loss of revenues identified by the transfer of customers and associated assets outlined in the June 28, 2018 agreement. However, the PSC report was relied upon in determining the viability of Southern Water District

## Company Expectations

The Southern Water District expects to continue to be viable after the transfer given the PSC rate increase and the reduction of debts afforded by proceeds from the contract dated June 28, 2018.

# National Economic and Industry Conditions

## General Economic Conditions and Outlook

The U.S. economic outlook is healthy according to experts. That's because the GDP growth rate will be between the 2 percent to 3 percent ideal range. Unemployment will continue at the natural rate. There isn't too much inflation or deflation. That's a Goldilocks economy.

Donald Trump promised to increase economic growth to 4 percent. That could create the irrational exuberance that creates damaging booms and busts.

U.S. GDP growth will rise to 2.1 percent in 2017. That's better than the 1.9 percent estimated for 2016 and the same as 2015's growth rate of 2.1 percent. The increase in gross domestic product will remain at 2.1 percent in 2018 and drop to 1.9 percent in 2019. That's according to the most recent forecast released at the Federal Open Market Committee meeting on March 15, 2017. That begins to take into account the impact of Trump's policies.

The unemployment rate will drop to 4.5 percent in 2017 and beyond. That's better than the 4.7 percent rate in 2016, and the Fed's 6.7 percent target. Most job growth is in low-paying retail and food service industries. Many people have been out of work for so long that they'll never be able to return to the high-paying jobs they used to have. That means structural unemployment increased. Federal Reserve Chair Janet Yellen admits a lot of workers are part-time and would prefer full-time work. That makes the unemployment rate seem artificially low. She considers the real unemployment rate to be more accurate. That rate is usually double the official rate.

Inflation will be 1.9 percent in 2017 and 2.0 percent in 2018 and beyond. These rates are higher than the 1.5 percent rate in 2016, and the 0.7 percent inflation experienced in 2015. Both were caused by low oil prices. The core inflation rate (without gas or food prices) will be 1.9 percent in 2017 and 2.0 percent in 2018 and beyond. That's close to the Fed's 2.0 percent target inflation rate.

U.S. manufacturing is forecast to increase faster than the general economy. Production will grow 3 percent in 2017, and 2.8 percent in 2018. Growth will slow to 2.6 percent in 2019 and 2 percent in 2020.

## Interest Rates

The FOMC first raised the Fed funds rate to 0.5 percent in December 2015 and raised interest rates again in December 2016 to 0.75 percent. It expects the rate to rise to 1.5 percent in 2017, 2 percent in 2018 and 3 percent in 2019. The fed funds rate controls short-term interest rates. These include banks' prime rate, the LIBOR, most adjustable-rate and interest-only loans, and credit card rates.

The Fed said it would start selling \$4 trillion in Treasuries after the Fed funds rate has normalized to about 2.0 percent. The Fed acquired these securities during quantitative easing, which ended in 2014. When it does start selling them, there will be more supply. That should raise the yield on the 10-year Treasury note. That drives up long-term interest rates, such as fixed-rate mortgages and corporate bonds. But Treasury yields also depend on demand for the dollar. If demand is high, yields will drop, and vice-versa. As the global economy improves, demand for this ultra-safe investment is falling. As a result, long-term and fixed interest rates will rise in 2017 and beyond.

## Oil and Gas Prices

The U.S. Energy Information Administration outlook is from 2017-2040. It predicts crude oil prices will average \$55/barrel in 2017. That's for Brent global. West Texas Crude will average around \$1/barrel or less.

The EIA warned that commodities traders believe prices will range between \$45/b and \$65/b for April 2017 delivery. Prices will rise to \$57/b in 2018. (Source: "Short-Term Energy Outlook," EIA, November 8, 2016)

A strong dollar continues to depress oil prices. That's because oil contracts are priced in dollars. Oil companies are laying off workers, and some may default on their debt. High-yield bonds funds are doing poorly as a result.

The oil market is still responding to the impact of U.S. shale oil production. That reduced oil prices 25 percent in 2014 and 2015. The good news for the economy is that it also lowered the cost of transportation, food, and raw materials for business. That raised profit margins. It also gave consumers more disposable income to spend. The slight slowdown is because both businesses and families are saving instead of spending.

By 2020, the average oil price will rise to \$76.57/b (in 2015 dollars, which removes the effect of \$136.21/b in 2040. By then, the cheap sources of oil will have been exhausted, making crude oil production more expensive. (Source: "Annual Energy Outlook," EIA, July 7, 2016.)

## Jobs

The Bureau of Labor Statistics publishes an outlook for U.S. employment each decade. It goes into great detail about each industry and occupation. Overall, the BLS expects total employment to increase by 20.5 million jobs from 2010-2020. While 88 percent of all occupations will experience growth, the fastest growth will occur in healthcare, personal care and social assistance, and construction. Furthermore, jobs requiring a master's degree will grow the fastest while those that only need a high school diploma will grow the slowest. (Source: BLS Occupational Outlook Summary)

The BLS assumes that the economy will fully recover from the recession by 2020 and that the labor force will return to full employment or an unemployment rate between 4-5 percent. The biggest growth (5.7 million jobs) will occur in healthcare and other forms of social assistance as the American population ages.

The next largest increase (2.1 million jobs) will occur in professional and technical occupations. Most of this is in computer systems design, especially mobile technologies, and management, scientific, and technical consulting. Businesses will need advice on planning and logistics, implementing new technologies, and complying with workplace safety, environmental, and employment regulations.

Other substantial increases will occur in education (1.8 million jobs), retail (1.7 million jobs) and hotel/restaurants (1 million jobs). Another area is miscellaneous services (1.6 million jobs). That includes human resources, seasonal and temporary workers, and waste collection.

As housing recovers, construction will add 1.8 million jobs while other areas of manufacturing will lose jobs due to technology and outsourcing.

### Summary:

The economy appears to be good at the national, regional, and local level that should allow Southern Water District to succeed under the current economic conditions resulting from the rate increase and debt reduction.

## Historical and Normalized Financial Statements

The lost revenues were arrived from the PSC report which was filed by the Southern Water District. The below represents what the District determined were their lost revenues. Prestonsburg City Utilities provided their estimate and was more detailed, and resulted in less lost revenues. However, we determined the PSC performed extensive work on the District's records and therefore were more reliable.

### Summary Historical Income Statements

The following tables provide a summary of Southern Water and Sewer District's lost revenues..

	2013	2014	2015	2016	2017
<b>Total Sales Revenue</b>	656,122	656,122	656,122	656,122	656,122
Total Cost of Goods Sold	173,277	173,277	173,277	173,277	173,277
<b>Gross Profit</b>	482,845	482,845	482,845	482,845	482,845
<b>Income From Operations</b>	482,845	482,845	482,845	482,845	482,845
<b>Net Income</b>	482,845	482,845	482,845	482,845	482,845

### Normalized Earnings and Net Cash Flow Summary

The following tables present various measures of normalized earnings and net cash flows that are available to apply in the valuation methods that follow later in this report.

#### Normalized Earnings

The table below summarizes the income and expense normalization adjustments and constructs the indicated measures of earnings on an adjusted basis. The District does not pay income taxes like normal companies.

	2013	2014	2015	2016	2017
Total Income & Expense Adjustments Before Tax	0	0	0	0	0
Less: Tax Effect	0	0	0	0	0
Less: Adjustment to Historic Tax	0	0	0	0	0
Plus: Adjustments to Net-of-Tax Items	0	0	0	0	0
<b>Net Adjustments</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
Plus: Historic Net Income	482,845	482,845	482,845	482,845	482,845
<b>Net Income</b>	<b>482,845</b>	<b>482,845</b>	<b>482,845</b>	<b>482,845</b>	<b>482,845</b>
Plus: Normalized Income Taxes	0	0	0	0	0
<b>EBT</b>	<b>482,845</b>	<b>482,845</b>	<b>482,845</b>	<b>482,845</b>	<b>482,845</b>
Plus: Normalized Interest Expense	0	0	0	0	0
<b>EBIT</b>	<b>482,845</b>	<b>482,845</b>	<b>482,845</b>	<b>482,845</b>	<b>482,845</b>
Plus: Normalized Depreciation & Amortization	0	0	0	0	0
<b>EBITDA</b>	<b>482,845</b>	<b>482,845</b>	<b>482,845</b>	<b>482,845</b>	<b>482,845</b>



## Valuation of Southern Water and Sewer District

We were engaged by Dean Hall President Southern Water and Sewer to issue a detailed report. Our objective was to estimate the Fair Market Value of lost revenue and associated assets of Southern Water and Sewer District's per contract as of June 28, 2018.

The standard of value used in our valuation of Southern Water and Sewer District is *Fair Market Value*. Fair Market Value is defined in IRS Revenue Ruling 59-60 as: "The price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts. Court decisions frequently state in addition that the hypothetical buyer and seller are assumed to be able, as well as willing, to trade and to be well informed about the property and concerning the market for such property."

The purpose of this valuation is Support Existing Sale and Transfer of customers and associated assets. This report is prepared for Dean Hall President Southern Water and Sewer and should not be used by others. This report is dated 10/31/2018.

There are a large number of factors to consider when estimating the common stock value of any business entity. These factors vary for each valuation depending on the unique circumstances of the business enterprise and general economic conditions that exist at the effective date of the valuation. However, fundamental guidelines of the factors to consider in any valuation have been established. The most commonly used valuation guidelines are derived from the Internal Revenue Service's Revenue Ruling 59-60. Revenue Ruling 59-60 states that in the valuation of the stock of closely held businesses, the following factors, although not all inclusive, are fundamental and require careful consideration in each case:

- a) The nature of the business and the history of the enterprise from its inception.
- b) The economic outlook in general and the condition and outlook of the specific industry in particular.
- c) The book value of the stock and the financial condition of the business.
- d) The earning capacity of the company.
- e) The dividend-paying capacity.
- f) Whether or not the enterprise has goodwill or other intangible value.
- g) Sales of the stock and the size of the block of stock to be valued.
- h) The market price of stocks of corporations engaged in the same or a similar line of business having their stocks actively traded in a free and open market, either on an exchange or over-the-counter.

Based on circumstances unique to Southern Water and Sewer District as of June 28, 2018, additional factors have been considered. Since we were charged with valuating specific customer revenues and associated assets, many of these factors were not applicable.

In addition to providing general valuation guidelines, Revenue Ruling 59-60 outlines other considerations and techniques for valuing businesses. The techniques are commonly divided into general approaches, i.e., the Asset, Income and Market approaches. Specific methods are then used to estimate the value of the total business entity under each approach. Our conclusion of Fair Market Value is determined based on the results of these methods and the specific circumstances surrounding the interest being valued.

## **Overview of Valuation Approaches and Methods**

As previously specified, various approaches have been used to value Southern Water and Sewer District. These approaches, described below, are the: 1) Asset Approach, 2) Income Approach, and 3) Market Approach.

### **Asset Approach**

The Asset Approach is generally considered to yield the minimum benchmark of value for an operating enterprise. The most common methods within this approach are Net Asset Value and Liquidation Value. Net Asset Value represents net equity of the business after assets and liabilities have been adjusted to their fair market values. The Liquidation Value of the business represents the present value of the estimated net proceeds from liquidating the Company's assets and paying off its liabilities.

### **Income Approach**

The Income Approach serves to estimate value by considering the income (benefits) generated by the asset over a period of time. This approach is based on the fundamental valuation principle that the value of a business is equal to the present worth of the future benefits of ownership. The term income does not necessarily refer to income in the accounting sense but to future benefits accruing to the owner.

The most common methods under this approach are Capitalization of Earnings and Discounted Future Earnings. Under the Capitalization of Earnings method, normalized historic earnings are capitalized at a rate that reflects the risk inherent in the expected future growth in those earnings. The Discounted Future Earnings method discounts projected future earnings back to present value at a rate that reflects the risk inherent in the projected earnings.

Additional methods under the Income Approach are Capitalization of Excess Earnings and Multiple of Discretionary Earnings. Commonly referred to as the "formula method," the Capitalization of Excess Earnings method determines the value of tangible and intangible assets separately and combines these component values for an indication of total entity value. Under the Multiple of Discretionary Earnings method, the entity is valued based on a multiple of "discretionary earnings," i.e., earnings available to the owner who is also a manager. Both of these methods are normally used to value small businesses and professional practices.

### **Market Approach**

The Market Approach compares the subject company to the prices of similar companies operating in the same industry. Comparable companies can be privately owned or publicly traded where the valuation multiples are determined from the purchase/sale price for the company. A common problem for privately owned businesses is a lack of publicly available comparable data. Comparable companies can also be publicly traded where the valuation multiples are derived from the trading price for the public companies stock as of the date of the valuation.

The methods utilized under each approach are presented and discussed in the following sections.

Less: Value of Total Liabilities

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## Equity Value Conclusions

We have estimated the Fair Market Value on a controlling interest, marketable basis for lost revenues and associated assets of Southern Water and Sewer District's transfer contract as of June 28, 2018 as described within this report.

Our conclusion is \$4,020,000 as summarized below. This conclusion is subject to the Statement of Assumptions and Limiting Conditions and the Representations presented in the following report. We have no obligation to update this report or our conclusion of value for information that comes to our attention after the date of this report.

In arriving at this opinion of value, we relied on a "value in use" or going-concern premise. This premise assumes that the Company is an ongoing business enterprise with management operating in a rational way with a goal of maximizing shareholder value.

### Enterprise-Level Equity Value

When there is more than one indication of value produced by the different valuation approaches and methods, the analyst must reconcile these values. Therefore, in arriving at our conclusion of the enterprise equity value for Southern Water and Sewer District, we assigned relative weights to the individual indications of enterprise-level equity value and calculated a weighted average of these values. The weighted-average enterprise-level equity value is \$4,020,000 as presented in the following table.

Southern Water and Sewer District Discounted Equity Net Cash Flows	Projected Equity Net Cash Flows	Discount Factor	Present Value Factor	Present Value 2017
FY 2018	482,906	1.000000	0.892777	431,127
FY 2019	482,906	2.000000	0.797052	384,901
FY 2020	482,906	3.000000	0.711590	343,631
FY 2021	482,906	4.000000	0.635291	306,786
FY 2022	482,906	5.000000	0.567174	273,892
Terminal Value of Equity Net Cash Flows **	4,020,864	5.000000	0.567174	<u>2,280,530</u>
<b>Operating Value</b>				4,020,866
<b>Calculated Equity Value</b>				<u>4,020,866</u>
<b>Indicated Equity Value</b>				4,020,000
End-of-Year Discount Factors are Based on the Discount Rate of:		12.01%		
Terminal Value is Based on the Capitalization Rate of:		12.01%		
** Calculated as Terminal Equity Net Cash Flows x (1 + LT Growth Rate) / Capitalization Rate				
Present Value Factor = 1 / (1 + Discount Rate) <sup>Discount Factor</sup>				
Discount Factor (end-of-year convention) Year 1 = 1, Year 2 = 2, etc.				

The calculation of the Cap Rate of 12.01% is on the next page.

Southern Water and Sewer District                      Cap Rate Build Up  
Discount Rate and Capitalization Rate Calculations and DCF Assumptions

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**Discount Rate and Capitalization Rate Calculations**

Discount Rate Method	Build-Up Method	
Risk-Free Rate		2.91%
<u>Market Equity Risk Premium from CAPM / Beta</u>		
Total Return on Asset Class	0.00%	
- Risk-Free Rate	2.91%	
= Subtotal	2.91%	
x Selected Beta	0.00	
= Market Equity Risk Premium		0.00%
<b>Other Risk Factors / Premiums:</b>		
Equity Risk		15.10%
Utility Factor		-8.00%
Specific Company Size Premium		2.00%
Discount Rate		12.01%
Earnings Base Conversion Adjustment		0.00%
<b>Adjusted Discount Rate</b>		12.01% <small>(Applied to future benefit stream.)</small>
Less: Long-Term Growth in Benefit Stream		0.00%
<b>Capitalization Rate</b>		12.01%
Divided by: (1 + Long Term Growth Rate)		100.00%
<b>Historic Earnings Capitalization Rate</b>		12.01% <small>(Applied to historic benefit stream.)</small>
<b>Excess Earnings Capitalization Rate</b>		26.00% <small>(Applied to historic excess earnings benefit stream.)</small>

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**Discounted Cash Flow and Earnings Calculation Based On**

Discounting Convention:                      Terminal / Residual Basis:  
     End of Year                      Terminal Earnings

Years for Discounting:                      Terminal Growth Rate:  
     5                                      0.00%

Terminal / Residual Value Calculation Method:  
     Gordon Method (level growth)

The utility industry has a lower Cap Rate than normal industries. The large utilities enjoy an average cap rate of 10%. I was able to support this rate with empirical data including specific to water and Ky companies. I added a Specific Company and Size premium of 2% due to the smaller size of District compared to the NYSE companies and other challenges the District faces in updating their assets.

## Appendix — Representations

The following factors guided our work during this engagement:

- The analyses, opinions, and conclusions of value included in this report are subject to the assumptions and limiting conditions specified previously in this report, and they are our personal analyses, opinions, and conclusion of value.
- The economic and industry data included in this report were obtained from sources that we believed to be reliable. We have not performed any corroborating procedures to substantiate that data.
- This engagement was performed in accordance with the American Institute of Certified Public Accountants Statement on Standards for Valuation Services.
- We have previously identified the parties for whom this information and report have been prepared. This valuation report is not intended to be, and should not be, used by anyone other than those parties.
- Our compensation for this engagement is not contingent on the outcome of this valuation.
- We have no obligation to update this report or our opinion of value for information that comes to our attention after the report date.

\_\_\_\_\_  
(Signature)

\_\_\_\_\_  
(Date)

\_\_\_\_\_  
(Signature)

\_\_\_\_\_  
(Date)

## **Appendix — Qualifications**

This report was prepared by Terry R. Fyffe President of The Fyffe Jones Group. Terry R. Fyffe holds the following professional designations and certifications: CPA, ABV.

### **CURRICULUM VITAE**

**TERRY R. FYFFE, CPA, ABV**

#### **Academic and Professional Credentials**

Bachelor of Science, Business Administration – Accounting Option, Morehead State University, 1977

Certified Public Accountant (CPA) issued by the AICPA, 1980-present

Accredited in Business Valuation (ABV) issued by the AICPA, 1998-present

Certified Financial Forensics (CFF) issued by the AICPA, 2008-present

#### **Position and Experience**

Managing Shareholder, The Fyffe Jones Group, 1984-present with offices in Huntington, West Virginia, Ashland, Kentucky and Portsmouth, Ohio

Manager, Kelley, Galloway & Company, 1977-1983

Performed valuations and testified as an expert witness on business valuation and other issues, 1980-present

Completed 64 hours and received the Certificate of Educational Achievement (CEA) in business valuations issued by the AICPA which included litigation support, 1995-1997

Completed 24 hours of the advanced Certificate of Educational Achievement, 1998-present including classes in litigation support

Attended AICPA Conference on Business Valuations annually for over 500 hours CPE, 1995-present and AICPA Conference on Litigation Support for 40 hours CPE along with numerous other Conferences including Healthcare/Physician, Divorce, etc.

#### **Professional Affiliations**

##### **American Institute of Certified Public Accountants**

Kentucky Society of Certified Public Accountants

West Virginia Society of Certified Public Accountants

Kentucky, West Virginia and Ohio Licensed

AICPA Consulting Section

Institute of Business Appraisers

Huntington Estate Planning Council Past President and Current Member

Board Member and Treasurer of Community College of Ashland Foundation Board

Board Member and Treasurer of Heritage, Arts, Science & Tourism Center

Board Member and President of Waipani Homeowners Association

KY Society of CPAs Key Contact for Tanya Pullin, Kentucky State Representative

## Appendix — Projections & Assumptions

### Projection Summary

	2017	2018	2019	2020	2021	2022
Net Sales Revenue		656,122	656,122	656,122	656,122	656,122
Gross Profit		482,906	482,906	482,906	482,906	482,906
EBITDA		482,906	482,906	482,906	482,906	482,906
EBIT		482,906	482,906	482,906	482,906	482,906
EBT		482,906	482,906	482,906	482,906	482,906
Net Income		482,906	482,906	482,906	482,906	482,906
Equity Net Cash Flows		482,906	482,906	482,906	482,906	482,906
Invested Capital Net Cash Flows		482,906	482,906	482,906	482,906	482,906
Net Change in Cash		482,906	482,906	482,906	482,906	482,906
Total Current Assets		482,906	965,812	1,448,717	1,931,623	2,414,529
Total Equity		482,906	965,812	1,448,717	1,931,623	2,414,529
Federal Income Tax Before NOL Adjustment		0	0	0	0	0
Plus: NOL Tax Adjustment		0	0	0	0	0
Federal Income Tax Expense		0	0	0	0	0

Equity Net Cash Flows (FCF-Equity)						
Net Income		482,906	482,906	482,906	482,906	482,906

### Summary Income Statement Projections

	2018	2019	2020	2021	2022
<b>Total Sales Revenue</b>	<b>656,122</b>	<b>656,122</b>	<b>656,122</b>	<b>656,122</b>	<b>656,122</b>
Total Cost of Goods Sold	173,216	173,216	173,216	173,216	173,216
<b>Gross Profit</b>	<b>482,906</b>	<b>482,906</b>	<b>482,906</b>	<b>482,906</b>	<b>482,906</b>
<b>Income From Operations</b>	<b>482,906</b>	<b>482,906</b>	<b>482,906</b>	<b>482,906</b>	<b>482,906</b>
<b>Net Income</b>	<b>482,906</b>	<b>482,906</b>	<b>482,906</b>	<b>482,906</b>	<b>482,906</b>

### Summary Cash Flow Projections

	2018	2019	2020	2021	2022
Net Cash Flow From Operations	482,906	482,906	482,906	482,906	482,906
Net Cash Flow From Investments	0	0	0	0	0
Net Cash Flow From Financing	0	0	0	0	0
<b>Net Cash Flow</b>	<b>482,906</b>	<b>482,906</b>	<b>482,906</b>	<b>482,906</b>	<b>482,906</b>
Cash at Beginning of Period	0	482,906	965,812	1,448,717	1,931,623
<b>Cash at End of Period</b>	<b>482,906</b>	<b>965,812</b>	<b>1,448,717</b>	<b>1,931,623</b>	<b>2,414,529</b>

## **Overview of Projection Assumptions**

In preparing the preceding financial statement projections, management made various assumptions about expected future revenues, expenses, assets, liabilities and equity. These assumptions were made after gathering and analyzing data that affects the future economic outlook of the Company. This data was derived from sources such as the normalized financial statements, publicly available information and other economic materials.

This section of the report provides a broad overview of the Projection Assumptions and has been prepared to emphasize items considered significant to the overall understanding of the projections.

## **Revenue & Expense Assumptions**

**Net Sales Revenues** over the past 5 historic years have grown at a compound average annual rate of 0.00%. Future Net Sales Revenues are projected to grow at an estimated, compound average annual rate of 0.00%, starting from a base amount of \$656,122 and growing to \$656,122 in the first projected year and \$656,122 in projected year 5.

**Total Cost of Goods Sold** over the past 5 historic years has averaged 26.41% of Net Sales Revenues for each respective year and was 26.41% of Net Sales Revenues in the most recent historic fiscal year, 2017. Total Cost of Goods Sold has been projected to be \$173,216, or 26.40% of Net Sales Revenues in the first projected year and \$173,216, or 26.40% of Net Sales Revenues in projected year 5. On average, Total Cost of Goods Sold has been projected to be 26.40% of each year's respective Net Sales Revenues.



### **Viability of Southern Water and Sewer District**

As part of my engagement, I was asked to provide an opinion as to the viability of Southern Water and Sewer District after the Agreement effective June 28, 2018 between the District and Prestonsburg City Utility Commission. In my opinion, the District is viable after the agreement based on the following:

The Kentucky Public Service Commission issued a report on the determination of the rate increase filed by the District. In addition to reviewing information provided by the filing, the Commission assigned staff members to do a thorough examination of the District's finances. Their conclusion was to approve a rate increase for both the basic and second tier rates than what the District had requested, which is very unusual by the Commission. The combination of these rate increases and the reduction of debt/working capital provided by the \$2,140,000 contract dated June 28, 2018 and the additional agreement of \$2,000,000, should make the viability of the District positive for many years based on my understanding. I place a great deal of reliance on the Commission's detailed work and confidence that the rate increase was sufficient to assure their success.

### **Viability of Prestonsburg City Utilities Commission**

As part of my engagement, I was asked to provide an opinion as to the viability of Prestonsburg City Utilities Commission after the Agreement effective June 28, 2018 between the Southern Water and Sewer District and Prestonsburg City Utility Commission. In my opinion, the District is viable after the agreement based on the following:

I reviewed the most current financial statement of Prestonsburg City Utilities Commission as of June 30, 2018. The City has been operating under a Management agreement to service these customers and perform services and maintenance/repairs on the associated assets for about two years. The financial statements reflected the actions taken by the City to update and improve the assets, including financing required to make substantial extensive improvements to the existing systems. In addition to the water revenues, the City was in the favorable position to provide sewer services for additional revenues. Many if not most of the subject customers were along the US 23 corridor and are commercial business accounts. Upon my site visit, we traveled US 23 to tour the customers affected by the transfer. After these improvements and additions, the City still showed Fund Balance Equity of over \$4M. Interview with Turner E. Campbell, Superintendent/CEO of Prestonsburg City Utilities Commission also confirmed my understanding of the financials and viability of the City Commission.

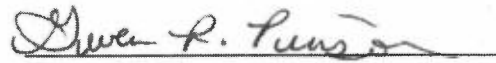
COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF SOUTHERN )  
WATER AND SEWER DISTRICT FOR AN ) CASE NO.  
ALTERNATIVE RATE ADJUSTMENT ) 2018-00230

NOTICE OF FILING OF COMMISSION STAFF REPORT

Notice is hereby given that, in accordance with the Commission's Order of July 20, 2018, the attached report containing the findings of Commission Staff ("Staff") regarding the Applicant's proposed rate adjustment has been filed in the record of the above-styled proceeding. Pursuant to the Commission's July 20, 2018 Order, Southern Water and Sewer District is required to file written comments regarding the findings of Commission Staff no later than 14 days from the date of this report.



Gwen R. Pinson  
Executive Director  
Public Service Commission  
P.O. Box 615  
Frankfort, KY 40602

DATE OCT 24 2018

cc: Parties of Record

PSC HANDOUT 01

STAFF REPORT  
ON  
SOUTHERN WATER AND SEWER DISTRICT

CASE NO. 2018-00230

Southern Water and Sewer District (Southern District) is a water utility district organized pursuant to KRS Chapter 74 that owns and operates a water distribution system through which it provides retail water service to approximately 5,456 customers residing in Floyd and Knott counties, Kentucky.<sup>1</sup> On July 3, 2018, Southern District tendered an application (Application) to the Commission requesting to increase its water service rates pursuant to 807 KAR 5:076. The Application was deemed filed as of July 12, 2018, after the filing deficiencies were cured. On July 25, 2018, the Attorney General filed a motion to intervene. By Order dated August 2, 2018, the Attorney General's motion was granted. To ensure the orderly review of the Application, the Commission established a procedural schedule by Order dated July 20, 2018.

Southern District based its requested rates on a historical test period that coincides with the reporting period shown in its most recent Annual Report on file with the Commission at the time it filed its Application the calendar year ended December 31, 2016, as required by 807 KAR 5:076, Section 9.

Southern District provided exhibits in its Application demonstrating that a 33.12 percent increase was reasonable, and requested an increase to its base monthly water rates in the amount of \$10.00 to the minimum bill of 2,000 gallons of usage, or 40.65 percent, and to increase any usage of 2,000 gallons by \$1.60, or 19.04 percent. The

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<sup>1</sup> *Annual Report of Southern Water & Sewer District to the Public Service Commission for the Calendar Year Ended December 31, 2017 ("Annual Report")* at 12 and 48.

rates requested by Southern District would increase the monthly bill of a typical residential customer<sup>2</sup> by \$13.20, from \$41.40 to \$54.60, or approximately 31.88 percent. Southern District presented financial exhibits in the Application that demonstrated how it calculated the amount of increase it could have justified. The exhibits are summarized below in condensed form.

Pro Forma Operating Expenses	\$3,489,146
Plus: Average Annual Principal and Interest Payments	528,385
Additional Working Capital	<u>105,677</u>
Overall Revenue Requirement	4,123,208
Less: Other Operating Revenue	(145,847)
Interest Income	(2,432)
Nonutility Income	<u>(143,033)</u>
Revenue Required from Rates	3,831,896
Less: Pro Forma Present Rate Service Revenues	<u>(2,878,486)</u>
Required Revenue Increase	<u>\$ 953,410</u>
Percentage Increase	<u>33.12%</u>

To determine the reasonableness of the rates requested by Southern District, Staff performed a limited financial review of Southern District's test-year operations. The scope of Staff's review was limited to determining whether operations reported for the test year were representative of normal operations. Known and measurable changes to test-year operations were identified, and adjustments were made when their effects were deemed material. Insignificant and immaterial discrepancies were not necessarily pursued or addressed.

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<sup>2</sup> A typical residential customer purchases 4,000 gallons of water per month through a 5/8-inch x 3/4-inch meter.

Staff's findings are summarized in this report. Ariel Miller reviewed the calculation of Southern District's Overall Revenue Requirement. Eddie Beavers reviewed Southern District's reported revenues and rate design.

### Summary of Findings

1. Overall Revenue Requirement and Required Revenue Increase. By applying the Debt Service Coverage (DSC) method, as generally accepted by the Commission, Staff found that Southern District's Overall Revenue Requirement is \$4,201,262, and that a \$1,110,415 revenue increase, or 37.87 percent, to pro forma present rate revenues is necessary to generate the Overall Revenue Requirement.

2. Water Service Rates. The Commission has previously found that the allocation of a revenue increase evenly across-the-board to a utility's current rate design is appropriate when there has been no evidence entered into the record demonstrating that this method is unreasonable. Southern District proposed to increase its retail rates with significantly different percentage increases. Southern District proposed to increase the First 2,000 Gallon step in its rate schedule by 40.65 percent and the Over 2,000 Gallon step in its rate schedule by 19.04 percent. Southern District did not provide an analysis or explanation as to why they chose to use the differing percentage increases to their rates, nor did they provide how this method was fair, just or reasonable to the customers. Southern District has not requested to increase its wholesale rates.

Staff has followed the Commission's accepted method in applying the increase to the rates and the rate schedule evenly across the board. Therefore, Staff has increased Southern District's current monthly retail water service rates across-the-board by 37.87

percent and allocated the \$1,110,415 revenue increase Staff found warranted evenly across-the-board.

Staff has reviewed Southern District's tariff and found no contract for its three wholesale customers listed in their tariff as wholesale customers. As there is no wholesale contract on file with the Commission, Staff would recommend that the Commission direct Southern District to file the contracts they have with these wholesale customers. Additionally, Staff has increased the wholesale customers' rates in the same manner that the retail water service rates were increased

3. Unauthorized Debt. As discussed in more detail beginning on page 12 of this report, Southern District currently has outstanding loans that are payable to First Guaranty Bank (First Guaranty) for which Southern District did not obtain Commission approval as required by KRS 278.300. Southern District has the responsibility to ensure that it follows the Commission's statutes and regulations and that all statutory and regulatory approvals are obtained. Southern District should be aware that the Commission may initiate a separate proceeding to more thoroughly investigate the possible violations of Commission statutes and regulations. If a determination is made that there has been a willful violation of any provision of KRS Chapter 278 and 807 KAR Chapter 5, the members of the Board of Commissions may be held accountable.<sup>3</sup>

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<sup>3</sup> KRS 278.990(1). Any officer, agent, or employee of a utility, as defined in KRS 278.010, and any other person who willfully violates any of the provisions of this chapter or any regulation promulgated pursuant to this chapter, or fails to obey any order of the commission from which all rights of appeal have been exhausted, or who procures, aids, or abets a violation by any utility, shall be subject to either a civil penalty to be assessed by the commission not to exceed two thousand five hundred dollars (\$2,500) for each offense or a criminal penalty of imprisonment for not more than six (6) months, or both.

## Pro Forma Operating Statement

Southern District's Pro Forma Operating Statement for the test year ended  
December 31, 2016, as determined by Staff, appears below.

	Test Year	Adjustment (Ref.)	Pro Forma
<b>Operating Revenues</b>			
Sales of Water	\$ 3,492,002	\$ (656,122) (A)	
		54,073 (B)	\$ 2,889,953
Sales for Resale	42,606	(213) (B)	42,393
Other Water Revenues	145,847	(17,811) (C)	128,036
<b>Total Operating Revenues</b>	<b>3,680,455</b>	<b>(620,073)</b>	<b>3,060,382</b>
<b>Operating Expenses</b>			
<b>Operation and Maintenance Expenses</b>			
Salaries and Wages - Employees	882,672		882,672
Salaries and Wages - Commissioners	23,500		23,500
Employee Pensions and Benefits	345,068		345,068
Purchased Water	450,826	(162,422) (D)	
		67,835 (E)	
		(153,959) (F)	202,280
Purchased Power for Pumping	450,099	(194,523) (F)	255,576
Chemicals	85,893	(37,121) (F)	48,772
Materials and Supplies	377,780	(18,000) (C)	359,780
Contractual Services	112,969		112,969
Transportation Expense	118,891		118,891
Insurance	197,513		197,513
Advertising Expense	507		507
Bad Debt Expense	145,417		145,417
Miscellaneous Expense	35,693		35,693
<b>Total Operation and Maintenance Expenses</b>	3,226,828	(498,190)	2,728,638
Taxes Other Than Income	110,240	(8,826) (G)	101,414
Depreciation	842,156	450 (C)	
		(10,855) (H)	831,751
Amortization	2,460		2,460
<b>Total Operating Expenses</b>	<b>4,181,684</b>	<b>(517,421)</b>	<b>3,664,263</b>
<b>Net Operating Income</b>	(501,229)	(102,652)	(603,881)
Interest Income	2,432		2,432
Nonutility Income	143,033	(115,000) (I)	28,033
<b>Income Available to Service Debt</b>	<b>\$ (355,764)</b>	<b>\$ (217,652)</b>	<b>\$ (573,416)</b>

(A) Reduction in Water Sales. During the test year, Southern District transferred its Sewer operations and a portion of their water customer base to the Prestonsburg City's Utility's Commission (PCUC) for financial considerations. Southern District provided a billing analysis that accounts for the lost revenues of (\$656,122) and the loss of 60,744,000 gallons sold to these 1,160 customers. Commission Staff finds that the billing analysis shows that these adjustments are reasonable and should be accepted by the Commission.

(B) Billing Analysis Adjustment. In the Application, Southern District provided a billing analysis that did not state specifically the number of bills for their retail or wholesale customers. In response to a deficiency letter, Southern District filed into the record an explanation describing the billing analysis calculations. To calculate the number of bills for the usage blocks, Southern District multiplied the number of customers in each usage block by 12. Southern District used the total from this calculation and multiplied it by the rate schedule usage for the First 2,000 gallons to derive the appropriate usage for each usage block for the First 2,000 gallons usage. Southern District then applied any additional usage to the Over 2,000 gallons usage block in their billing analysis. Southern District's consultant, Holly Nicholas, Kentucky Engineering Group, LLC, provided the explanation because she was responsible for the development of the billing analysis Southern District provided in their Application.<sup>4</sup> Southern District replaced their billing software during the test year, which made the information for the full test year inaccessible. With the new billing software, Southern District should be placed on notice

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<sup>4</sup> Southern District response to field review filed on July 12, 2018.



that the Commission may expect that in future filings, Southern District should provide the information in its billing analysis in the appropriate manner.

Staff has reviewed Southern District's billing analysis and the adjustments provided in the Application and finds that the retail water sales revenues of \$2,889,953 and the wholesale water sales revenues of \$42,393, as determined by the adjusted billing analysis, is an accurate representation of normalized test-year revenue from water sales.<sup>5</sup> Therefore, Staff has increased retail water sales revenue by \$54,073 and decreased sales for resale water revenues by \$(213).

(C) Tap Fees. During the test year, Southern District installed 24 new water connections to its distribution system. Southern District recorded \$17,811 for collections from customers for water taps in Other Water Revenues. Additionally, Southern District did not capitalize the expenses associated with setting these water taps. Staff removed \$17,811 from Other Water Revenues and removed \$18,000 from materials and supplies to reflect the costs of setting the taps. Staff then capitalized the amounts associated with setting the water taps in the amount of \$450 as calculated below.

5/8 Inch x 3/4 Inch Water Tap on Charge	\$	750
Times: Number of Taps in 2016		<u>24</u>
Total Water Tap on Charges		18,000
Divide by: 40 Years		<u>40</u>
Adjustment	\$	<u><u>450</u></u>

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<sup>5</sup> The billing analysis is based on a non-standard billing analysis due to the unavailability of the actual test-year billing data and the accuracy is representative of Southern Districts assumptions and estimates.

(D) Reduced Purchased Water. In its Application and as discussed in Item (A) above, Southern District reduced water sales due to the transfer of water assets and customers to PCUC. As a result, water that was purchased in order to serve these customers will also be reduced. Staff has reduced pro forma Purchased Water by \$162,422, as calculated below, for the total gallons of water purchased, adjusted for water loss as discussed in Item (F) below, to serve the customers in that area.

Gallons of Water Not Sold	60,744,000
Times: Water Loss Adjustment	<u>1.582178</u>
Total Gallons of Water Purchased	96,107,820
Divide by:	<u>1,000</u>
Gallons Purchased (omit 000's)	96,108
Times: 2016 Purchased Water Rate	<u>\$ 1.69</u>
Downward Adjustment	<u><u>\$ 162,422</u></u>

(E) Wholesale Rate Increase. On September 18, 2018, Southern District filed into the record a letter and notice for the city of Pikeville (Pikeville) regarding an increase to the wholesale water rate charged to Southern District. The notice indicated that Pikeville proposed to increase its rate for wholesale water service to Southern District from \$1.72 per 1,000 gallons to \$2.25 per 1,000 gallons. The rates were to be effective October 16, 2018. As of the date of this report, Southern District has not objected to the wholesale rate increase proposed by Pikeville. Staff has increased Southern District's purchased water expense by \$67,835 as calculated below, for water purchased from Pikeville in the test year.

Gallons Purchased in Test Year (in 000's)	127,990
Times: New Purchased Water Rate	\$ 2.25
Purchased Water Expense	287,978
Less: Test Year	<u>(220,143)</u>
Increase	<u>\$ 67,835</u>

(F) Expenses Attributable to Water Loss. In its Annual Report, Southern District reported water loss of 42.85 percent.<sup>6</sup> During Staff's review, it was determined that Southern District reported for its annual System flushing and Fire department use on its Water Statistics summary of the annual report in the amount of 60 million gallons each. Southern District was unable to provide sufficient flushing records or records of fire department use at the time of Staff's review. Staff has reduced the amounts reported for system flushing and fire department use to zero gallons, as no reasonable alternative level could be determined for these categories. As a result, Southern District's water loss has been increased to 58.22 percent<sup>7</sup> for ratemaking purposes. Section 6(3) of 807 KAR 5:066 limits water loss to 15 percent for ratemaking purposes unless an alternative level

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<sup>6</sup> Annual Report at 56.

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Water Produced and Purchased	781,024,000
Less: Water Sales	(314,359,000)
Less: Water Treatment Plant Use	(11,940,000)
Less: Wastewater Plant Use	<u>(30,000)</u>
Total Line Loss	454,695,000
Divide by: Water Produced and Purchased	<u>781,024,000</u>
Water Loss Percentage	<u>58.22%</u>

is found reasonable by the Commission.<sup>8</sup> As shown below, Staff calculated the cost to purchase, pump, and treat excess water loss to be \$385,603.

	Test Year	Times: Excess Water Loss Percentage	Decrease
Purchased Water	\$356,239	-43.22%	\$(153,959)
Purchased Power	450,099	-43.22%	(194,523)
Chemicals	85,893	-43.22%	(37,121)

Accordingly, Staff removed the amounts attributable to excess water loss in pro forma operations.

(G) Sales Tax. In the test year, Southern District included in Taxes Other Than Income payments that were made for sales taxes collected on behalf the Commonwealth of Kentucky. The collection, and likewise remittance, of these taxes is not an expense or income to Southern District. Accordingly, Staff removed the payments made for Sales Tax from pro forma operations.

(H) Depreciation. In the test year, Southern District recorded depreciation on water assets that are to be transferred to PCUC as approved in Case No. 2017-00044.<sup>9</sup>

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<sup>8</sup> 807 KAR 5:066, Section 6(3), states: "Unaccounted-for water loss. Except for purchased water rate adjustments for water districts and water associations, and rate adjustments pursuant to KRS 278.023(4), for ratemaking purposes a utility's unaccounted-for water loss shall not exceed fifteen (15) percent of total water produced and purchased, excluding water used by a utility in its own operations. Upon application by a utility in a rate case filing or by separate filing, or upon motion by the commission, an alternative level of reasonable unaccounted-for water loss may be established by the commission. A utility proposing an alternative level shall have the burden of demonstrating that the alternative level is more reasonable than the level prescribed in this section."

<sup>9</sup> Case No. 2017-00044, *Electronic Joint Application of Southern Water and Sewer District; Prestonsburg City's Utility Commission; and the City of Prestonsburg for an Order Approving the Transfer of Ownership of the Wastewater System and Certain Portions of the Water System of Southern Water and Sewer District* (Ky. PSC May 2, 2017).

As of the date of this report, the water assets have not yet been transferred to PCUC. Until the transfer has occurred, Southern District and PCUC have mutually signed and agreed to an Operating and Maintenance Agreement (Agreement) that had an effective date of July 1, 2017. Pursuant to the Agreement, PCUC is principally responsible for maintaining the portion of Southern District's system that is to be transferred to PCUC. Additionally, PCUC will collect the water service revenues for the customers' meters that are being maintained by PCUC. Even though Southern District has not yet relinquished control of the assets to PCUC, pursuant to the Agreement, Southern District is neither collecting the revenue for these customers nor is it maintaining the assets in question, and therefore the depreciation for these assets should not be included in expenses for ratemaking purposes. Staff has removed from pro forma expenses the \$10,855 of depreciation recorded in the test year for these assets that had an original cost of \$542,732.<sup>10</sup>

(I) Nonutility Income. During the test year, Southern District received a payment from PCUC in the amount of \$115,000 that Southern District stated was an advance on the pending transfer of the water and wastewater assets to PCUC. This advance is a transaction that would not normally occur during the normal course of business, and therefore Staff has removed the amount received from PCUC from test year operations.

#### Overall Revenue Requirement and Required Revenue Increase

The Commission has historically applied a DSC method to calculate the Overall Revenue Requirement of water districts and water associations. This method allows for

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<sup>10</sup> Case No. 2017-00044, Response to Commission Staff's Second Request for Information (Apr. 21, 2017) at 2.

recovery of: (1) Cash-related pro forma operating expenses; (2) recovery of depreciation expense, a non-cash item, to provide working capital;<sup>11</sup> (3) the average annual principal and interest payments on all long-term debts; and (4) working capital that is in addition to depreciation expense.

A comparison of Southern District's and Staff's calculations of the Overall Revenue Requirement and Required Revenue Increase using the DSC method is shown below.

	Southern District	Staff	
Pro Forma Operating Expenses	\$3,489,146	\$ 3,664,263	
Plus: Average Annual Principal and Interest Payments	528,385	447,499	(1)
Additional Working Capital	<u>105,677</u>	<u>89,500</u>	(2)
Overall Revenue Requirement	4,123,208	4,201,262	
Less: Other Operating Revenue	(145,847)	(128,036)	
Interest Income	(2,432)	(2,432)	
Nonutility Income	<u>(143,033)</u>	<u>(28,033)</u>	
Revenue Required from Rates	3,831,896	4,042,761	
Less: Pro Forma Present Rate Service Revenues	<u>(2,878,486)</u>	<u>(2,932,346)</u>	
Required Revenue Increase	<u>\$ 953,410</u>	<u>\$ 1,110,415</u>	
Percentage Increase	<u>33.12%</u>	<u>37.87%</u>	

<sup>11</sup> The Kentucky Supreme Court has held that the Commission must permit a water district to recover its depreciation expense through its rates for service to provide internal funds for renewing and replacing assets. *See Public Serv. Comm'n of Kentucky v. Dewitt Water Dist.*, 720 S.W.2d 725, 728 (Ky. 1986). Although a water district's lenders require that a small portion of the depreciation funds be deposited annually into a debt reserve/depreciation fund until the account's balance accumulates to a required threshold, neither the Commission nor the Court requires that revenues collected for depreciation be accounted for separately from the water district's general funds or that depreciation funds be used only for asset renewal and replacement. The Commission has recognized that the working capital provided through recovery of depreciation expense may be used for purposes other than renewal and replacement of assets. *See Case No. 2012-00309, Application of Southern Water and Sewer District for an Adjustment in Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC Dec. 21, 2012).

(1) Average Annual Principal and Interest Payments. At the time of filing, Southern District had four outstanding bonds payable to the United States Department of Agriculture Rural Development (RD), four notes payable to the Kentucky Infrastructure Authority (KIA), and two loans payable to First Guaranty. KRS 278.300(1) states "no utility shall issue any securities or evidences of indebtedness, or assume any obligation or liability in respect to the securities or evidences of indebtedness of any other person until it has been authorized to do so by order of the commission." Accordingly, *prima facie* evidence exists that Southern District violated KRS 278.300(1). The Commission is compelled to pursue a separate action against Southern District to show cause and present evidence on its failure to adhere to the procedures of KRS 278.300(1). In instances in which it is shown that the proceeds of an unauthorized loan were used to pay for current operating expenses, the Commission has disallowed rate recovery, finding that such action would constitute retroactive ratemaking.<sup>12</sup> Staff has determined that Southern District used the proceeds from the First Guaranty loan to pay for current operating expenses, and therefore finds that Southern District should not be allowed rate recovery of the associated debt service.

In its Application, Southern District requested recovery of the average annual principal and interest payments on these loans, and the two notes that it is in the process of obtaining approval for from KIA, which it calculated to be \$528,385 based on a three-year average of the annual principal and interest payments for the years 2018 through 2020. Traditionally, Staff only makes adjustments to a utility's pro forma operations when

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<sup>12</sup> See Case No. 8690, *Application of Glengarry Utilities, Inc., Glengarry Sewage Treatment Plant, for an Adjustment of Rates Pursuant to the Alternative Procedure for Small Utilities* (Ky. PSC July 8, 1983) at 7; and Case No. 9303, *Application of Fordhaven, Inc., for an Adjustment of Rates Pursuant to the Alternative Procedure for Small Utilities* (Ky. PSC Aug. 8, 1985) at 8.

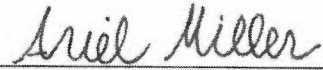
those adjustments are determined to be known and measurable. As it is uncertain whether the two proposed notes payable to KIA will be approved and have not yet been reviewed by the Commission, Staff determined this proposed adjustment was not known and measurable. Staff recalculated this amount using the three-year average of the annual principal and interest payments for the years 2019 through 2021 but excluded the two loans payable to First Guaranty, and the two proposed notes payable to KIA that have not yet been approved. The recalculation of Southern District's debt service is shown below.

Year	Annual Debt Payment
2019	\$ 447,597
2020	447,374
2021	<u>447,527</u>
Total	1,342,498
Divide by: 3 years	<u>3</u>
Average Annual Principal and Interest Payment	<u>\$ 447,499</u>

(2) Additional Working Capital. The DSC method, as historically applied by the Commission, includes an allowance for additional working capital that is equal to the minimum net revenues required by a district's lenders that are above its average annual debt payments. In addition to depreciation expense, Southern District requested recovery of an allowance for working capital that is equal to 120 percent of its average annual debt payments for its four bonds payable, current notes payable to KIA, two loans payable to First Guaranty, and the proposed notes payable to KIA, respectively.

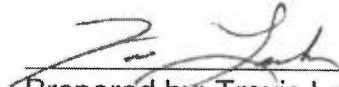


Signatures



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Prepared by: Ariel Miller  
Water and Sewer Branch  
Division of Financial Analysis



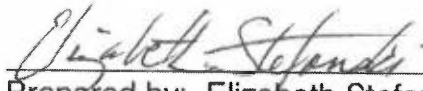
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Prepared by: Travis Leach  
Water and Sewer Branch  
Division of Financial Analysis



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Prepared by: Eddie Beavers  
Water and Sewer Branch  
Division of Financial Analysis



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Prepared by: Elizabeth Stefanski  
Water and Sewer Branch  
Division of Financial Analysis

RD requires that Southern District charge rates that produce net revenues that are at least 120 percent of its average annual debt payments. Following the Commission's historic practice, Staff recalculated Southern District's allowance for additional working capital as shown below.

Average Annual Principal and Interest	\$ 447,499
Times: DSC Coverage Ratio	<u>120%</u>
Total Net Revenues Required	536,999
Less: Average Annual Principal and Interest Payments	<u>(447,499)</u>
Additional Working Capital	<u>\$ 89,500</u>

ATTACHMENT

ATTACHMENT TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 2018-00230 DATED **OCT 24 2018**

Staff Calculated Monthly Water Rates

First	2,000 Gallons	\$33.92	Minimum Bill
Over	2,000 Gallons	11.58	per 1,000 Gallons

Wholesale Customers

City of Hindman	3.78	per 1,000 Gallons
Knott County Water District	3.86	per 1,000 Gallons
City of Wheelwright	3.75	per 1,000 Gallons

\*Southern Water & Sewer District  
245 Kentucky Route 680  
P. O. Box 610  
McDowell, KY 41647

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