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PUBLIC SERVICE  
COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF SOUTHERN WATER	)	
AND SEWER DISTRICT FOR AN	)	CASE NO. 2019-00131
ALTERNATIVE RATE ADJUSTMENT	)	

**ATTORNEY GENERAL’S COMMENTS ON STAFF REPORT**

Comes now the intervenor, the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention (“Attorney General”), and in accordance with the Kentucky Public Service Commission (“Commission”)’s procedural schedule issued May 16, 2019, hereby tenders his comments on the Commission Staff Report in the above-styled action.

**STATEMENT OF THE CASE**

Southern Water and Sewer District (“Southern” or the “District”) is a water utility district organized under KRS Chapter 74, which currently serves approximately 5,452 customers in Floyd and Knott counties.<sup>1</sup> Southern filed the instant application for a rate adjustment under the alternative rate filing (“ARF”) procedure on April 19, 2019. This followed the Commission’s denial of rates in a prior ARF application, Case No. 2018-00230, due to an incomplete billing analysis for the historical test year.<sup>2</sup> In its current application, Southern requested an expedited review and an emergency rate increase during the pendency of the ARF rate case. On April 26, 2019, the Commission ordered an evidentiary hearing to consider an emergency rate increase, which was subsequently held on May 9, 2019. On July 17, 2019 the Commission issued an order

<sup>1</sup> *Application of Southern Water and Sewer District for an Alternative Rate Adjustment* [“Application”], Case No. 2019-00131 (Ky. Commission April 19, 2019).

<sup>2</sup> Commission Order, *Electronic Application of Southern Water and Sewer District for an Alternative Rate Adjustment*, Case No. 2018-00230 (Ky. Commission January 31, 2019).

advising that due to additional discovery being necessary and a delay in receiving responses and required information, the Staff Report would not be issued before August 16, 2019. On August 15, 2019, the Commission issued its Staff Report.

## **COMMENTS**

### **Revenue Requirement**

Initially, the Attorney General is concerned with the overall level of the revenue requirement recommended by Staff. Though Staff recommended less than Southern requested in its application, the rates based on this revenue requirement, if approved, may well be the highest retail water rates in the Commonwealth. Approving such high rates in addition to recommending a Meter Replacement Surcharge compounds the impact on Southern's customers, who are already paying for the mismanagement, poor planning, and neglect of the system shown by past District leadership.

As to the recommended steps for the District moving forward, the Attorney General agrees with Staff on the following. He agrees that the Commission should order a refund for any over-collection that may have occurred due to the interim flat rates and the interim commercial rates in excess of any approved rates and that the District should provide an explanation and context for how it will complete any necessary refunds. The Attorney General further agrees that as retail customers receive new meters, the District should begin charging the approved customer charge and volumetric rates, and that the District should file a new application for an ARF after a full year's worth of data regarding usage and expenses have been compiled, which will allow for new rates based on accurate usage and to correct any possible remaining over- or under-collection from its customers. Finally, he also agrees with Staff that due to evidence regarding meter accuracy in

this case and in Case No. 2019-00041,<sup>3</sup> the billing analysis used to compute the commercial customer rate may also contain inaccuracies and that the recommendation to require another ARF after one year of billing data has been collected is a sound one. This will allow the District to identify any instances of over or under-billing and refund those customers accordingly.

### **Water Service Rates / Rate Design**

As a general matter, the Attorney General agrees with Staff's recommendation that the Commission order Southern to install new meters as soon as possible. As expressed in his prior comments, the Attorney General believes that new, advanced meters are essential to the stabilization of the District's short-term finances and long-term viability as a utility.

As already stated, the Attorney General is greatly concerned with the recommendation to approve rates to achieve the revenue requirement as calculated by Staff. Notwithstanding those concerns, the Attorney General does agree with Staff's changes to the rate design. The minimum bill proposed by the District, \$33.34 for the first 2,000 gallons used, unfairly punishes low users and would produce rate shock among all retail customers who would have no way to reduce their bill until after they have used 2,000 gallons. Staff's recommendation to institute a customer charge, and a two-step declining block volumetric rate does allow for those customers with lower usage to better control the final bill amount and would better minimize rate shock. Thus, the Attorney General also recommends that the Commission adopt a rate structure which aligns with that proposed by Staff.

### **Pro Forma Adjustments**

#### **Capitalization of Meter Installations**

The Attorney General agrees with Staff's recommendation to treat the expenses for meter

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<sup>3</sup> *Electronic Investigation into Excessive Water Loss by Kentucky's Jurisdictional Water Utilities*, Case No. 2019-00041 (Ky. Commission March 12, 2019).

installations as a capitalization, thereby reducing the District's operating expense by the same amount. Further, the Attorney General does not object to the Staff's recalculation of the amount of the reduction.

### **Employee Pensions and Benefits / District Employee Expenses**

The Attorney General agrees with Staff's recommended adjustments to the expenses for Southern's employee pensions and benefits, which adhere to the Commission's recent emphasis on aligning utilities' expenses for employee compensation with those in the broader competitive market. The ensuing adjustments to disallow the portion of health and dental insurance premiums above the average employee contribution rate in the market are reasonable and in line with Commission precedent.

As to the overall employee expenses, Staff neglected to address the amount of the reported, test year expenses as they pertain to the current management structure and reduced number of employees from the test year. During Southern's hearing for Case No. 2019-00041, the District confirmed that it expected to approve an extension of UMG's current six month contract, which began in March 2019 and runs out in September 2019, for another six months.<sup>4</sup> The employment expenses in Southern's Pro Forma Operating Expenses utilized a test year ended December 31, 2018.<sup>5</sup> Thus, with UMG's current management and operation of the District, and the reduction from the 2018 employee count,<sup>6</sup> Southern's employment expenses for employee salaries, wages, pensions, and benefits are not as high as the amount listed in the Staff Report. This difference in expense should be more fully developed and taken into account in the Commission's determination of final rates. Nevertheless, the Commission should not take into account short-term management

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<sup>4</sup> Case 2019-00041, Southern Water and Sewer District Hearing July 16, 2019, Video Transcript Evidence ["VTE"], at 1:38:25—1:41:30.

<sup>5</sup> Staff Report, at 7.

<sup>6</sup> Case 2019-00041, Southern Water and Sewer District Hearing July 16, 2019, VTE, at 1:36:40—1:37:20.

contracts in calculating an on-going, and representative, annual revenue requirement.

#### **Wholesale Purchased Water**

The Attorney General agrees with Staff's recommendation to accept Southern's adjustment to its Wholesale Purchased Water expense to match the wholesale rates it is being charged by its suppliers, which in turn increased the District's pro forma operations Purchased Water Expense.

#### **Expenses Attributable to Water Loss**

The Attorney General agrees with Staff's calculation and removal of costs related to the purchase, production, pumping, and treatment of water for the amount in excess of the 15% limit enumerated in 807 KAR 5:066, Section 6. The Attorney General recommends the removal of these expenses and reiterates the importance of new meters in reducing these costs in future cases.

#### **Attorney's Fees**

The Attorney General agrees with Staff's recommendation to remove the cost of legal fees for the District's prior counsel. Without sufficient specificity of services rendered and itemization of charges, nor confirmation of the attorney's attendance at the board meetings, the District has failed to meet its burden by not providing adequate support for these expenses. Accordingly, the Attorney General also recommends that these expenses be disallowed for ratemaking.

#### **Miscellaneous Expenses**

The Attorney General agrees with Staff's removal of \$54,756 in Miscellaneous Expenses from the pro forma expenses. As to the portion of Miscellaneous Expenses totaling \$33,193, which Staff removed from the pro forma and termed "questionable and ... not necessary for the provision of water service to Southern District's customers", the Attorney General urges the Commission to take a stronger stance. In a case earlier this year, Case No. 2019-00048, the Commission denied a proposed tariff revision by quoting a long-standing Attorney General opinion, stating:

To expend any part of the funds arising from fees for water services for any purpose other than those for which the district was created is to contravene the provisions contained in sections 171 and 180, State Constitution, and to do so, is illegal.<sup>7</sup>

The Commission should continue to adhere to this precedent. With an understanding that Southern has seen substantial turnover in the last year and that certain “bad actors” are no longer involved with the District, the Commission should nevertheless remind the District that future expenditures which fall outside the provision of water services may require personal reimbursement from those individuals at the District who incurred such costs.<sup>8</sup>

### **Depreciation Related to Transfer of Assets**

The Attorney General agrees with Staff’s recommendation to remove the pro forma expenses which relate to the water assets not yet transferred to Prestonsburg City Utilities Commission (“PCUC”), from the depreciation category in the test year. Though the transfer was approved in 2017-00044,<sup>9</sup> the assets have not been fully transferred and significant uncertainty remains as to the ultimate fate of the transaction. While Southern is neither collecting the revenue from the transferred customers nor maintaining this portion of the system, it should not be allowed to recover depreciation expenses from its other ratepayers.

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<sup>7</sup> Commission Order, *Tariff Filing of Webster County Water District to Implement the Servline Leak Protection Program*, Case No. 2019-00048 (Ky. Commission July 25, 2019) (quoting 1956 OAG 36,219 (Oct. 19, 1956)). See also Commission Order, *Application of West Carroll Water District for an Adjustment in Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities*, Case No. 2012-00433 (Ky. Commission January 29, 2013); Staff Report, *Application of Henderson County Water District for An Alternative Rate Filing*, Case No. 2013-00154 (Ky. Commission August 15, 2013); Staff Report, *Alternative Rate Adjustment Filing of Rattlesnake Ridge Water District*, Case No. 2013-00338 (Ky. Commission December 16, 2013); Commission Order, *Application of Northern Kentucky Water District for an Adjustment of Rates, Issuance of Bonds, and Tariff Changes*, Case No. 2010-00094 (Ky. Commission January 7, 2011).

<sup>8</sup> See Commission Order, *Application of Northern Kentucky Water District for an Adjustment of Rates, Issuance of Bonds, and Tariff Changes*, Case No. 2010-00094, Footnote 70 (Ky. Commission January 7, 2011).

<sup>9</sup> Commission Order, *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*, Case No. 2017-00044 (Ky. Commission May 2, 2017).

## **Depreciation Expense**

The Attorney General agrees with Staff's recalculation of the depreciable lives of the District's assets to rely on the midpoint of the NARUC recommended ranges. Accordingly, the Attorney General agrees with the pro forma deductions to the District's depreciation expense category to reflect those service life changes. The Attorney General does not object to Staff's treatment of Southern's distribution and transmission mains in this instance, given that the Commission has previously ruled on the issue upon the set of facts given in Case No. 2012-00309,<sup>10</sup> to maintain the 50-year service life on Southern's mains in accordance with the prior ruling of the Commission. Finally, the Attorney General agrees with the treatment Staff afforded to tank repairs, keeping these expenses on the depreciation schedule with a useful life of 15 years instead of amortizing them as a regulatory asset.

## **Overall Revenue Requirement and Required Revenue Increase**

### ***Average Annual Principal and Interest Payments***

Through the course of this case in another docket, Case No. 2019-00243, Southern requested and was granted permission to incur indebtedness, in an amount up to \$150,000, to Community Trust Bank in order to refinance the loan originally taken out with Floyd County Fiscal Court.<sup>11</sup> The Attorney General notes that these loans were not referenced in the Staff Report of the instant case, and if they were to be taken into account they would substantially add to the District's principal and interest payments as previously calculated. Furthermore, Southern's inability to timely and/or properly request and receive permission to refinance this loan put it in the position of being required to pay liquidated damages by the terms of the original loan with Floyd County

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<sup>10</sup> Commission Order, *Application of Southern Water and Sewer District for an Adjustment in Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities*, Case No. 2012-00309 (Ky. Commission July 12, 2013).

<sup>11</sup> Commission Order, *Electronic Application of Southern Water & Sewer District for Approval of Financing Pursuant to KRS 278.300*, Case No. 2019-00243 (Ky. Commission August 14, 2019).

Fiscal Court.<sup>12</sup> Though it seems that the District may not be required to pay these damages at this time, the fact that it was or is a possibility remains troubling.<sup>13</sup> The District recently filed a non-executed copy of the loan agreement into the record, which lists a maturity date of August 23, 2026, which without signatures is simply academic.<sup>14</sup> Furthermore, the original loan from Floyd County Fiscal Court was on a repayment term of only 3 months,<sup>15</sup> while Southern first sought approval for a refinancing of this loan in this docket, for a term of 48 months (4 years), which was denied.<sup>16</sup> The current agreement's increased term of 84 months (7 years) suggests a troubling trend of having to extend the repayment horizon when the District's circumstances necessitated the refinancing, especially since the initial loan did not require Commission approval and was essentially bootstrapped into a loan of more than two years, which does require approval.<sup>17</sup>

#### **Meter Replacement / Bid Results**

Additionally, Southern filed into the record information it received in response to its request for bid proposals on new meters for its system. The Attorney General recognizes the context and relative clarity this may provide to the record, which he encourages, in regard to the surcharge recommended by Commission Staff, but he also recommends that the Commission require the District to file a Certificate of Public Convenience and Necessity ("CPCN") in order to gain specific approval for its meter replacement program. The requirement of an approved CPCN prior to the implementation of a major investment in smart meters is in line with relevant statutes,<sup>18</sup>

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

<sup>13</sup> *Id.* at 2. (The order specifies that if the District is eventually required to pay the liquidated damages, they should be paid out of the District's operating account).

<sup>14</sup> Southern Water and Sewer District Notice of Filing of Loan Agreement, Case No. 2019-00131 (Ky. Commission August 28, 2019).

<sup>15</sup> Application, Exhibit A, Case No. 2019-00243 (Ky. Commission July 26, 2019).

<sup>16</sup> Commission Order, Case No. 2019-00131 (Ky. Commission July 10, 2019); Southern Water and Sewer District Motion for Approval of Loan, Case No. 2019-00131 (Ky. Commission July 8, 2019).

<sup>17</sup> KRS 278.300.

<sup>18</sup> KRS 278.020.



and recent Commission direction and precedent.<sup>19</sup>

The Attorney General remains concerned that the District is not moving fast enough in implementing new meters, which have been identified as the most important and cost effective way to ensure sufficient revenue, which in turn would help address the long-standing water loss issues.<sup>20</sup> In Southern's most recent hearing, which was primarily related to water loss issues, the Commission expressed similar concerns regarding the timeline of the bid process for new meters.<sup>21</sup> As it stands, residential customers will only move from the current flat rate to the two step rate design recommended by Staff when they have received a new meter.<sup>22</sup> The Staff's suggestion that the Meter Replacement Surcharge be set "at \$5.25 per customer per month for five years, or until such time that Southern District puts the total cost for the new meters, whichever comes first" is also somewhat troubling given the District's past performance, in that customers may be forced to pay this surcharge for the full five years while also expecting at least one additional rate case after a year's worth of data has been compiled, and possibly more during those five years depending on the District's financial health.<sup>23</sup> Southern customers face these rising costs amid uncertainty, with little clarity as to when they will receive new meters, and the associated benefits of those meters.

The Attorney General has grave concerns that Southern's long-term viability as a standalone functioning public utility still hangs in the balance. Its history of mismanagement is still apparent in the test year expenses, and the new leadership has yet to chart a clear course toward sustainability. UMG's management is only temporary. The District must continue to demonstrate

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<sup>19</sup> Commission Order, *Consideration of the Implementation of Smart Grid and Smart Meter Technologies*, Case No. 2012-00428 (Ky. Commission April 13, 2016).

<sup>20</sup> It would also reduce any need for higher customer charges or minimum bill amounts.

<sup>21</sup> Case 2019-00041, Southern Water and Sewer District Hearing July 16, 2019, VTE, at 25:00—38:00.

<sup>22</sup> Staff Report, Appendix A.

<sup>23</sup> Staff Report, at 6.

incremental progress through implementing new meters to accurately measure usage, applying that information in its leak detection efforts, steadily reducing water loss, all while properly maintaining its system infrastructure and prudently managing its expenditures. The Attorney General will closely track the District's efforts toward such improvements and if those fail to materialize, his office may offer different recommendations.

### **CONCLUSION**

The Staff Report did not address at least one of the issues which surfaced at the emergency hearing: the apparent mismatch between the invoices and payments for Frasure Electric. While there may have been no ill intent, and the discrepancies may be due to plain human error, they should be part of the Commission's consideration in its final determination on rates. Unnecessary or unreasonable costs should not be used as the basis to set rates moving forward.

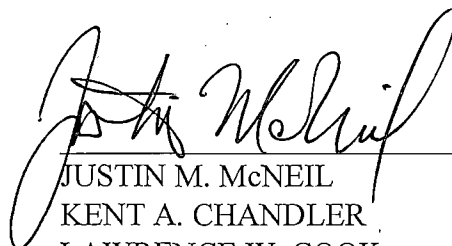
The Attorney General recognizes that Southern needs an increase in revenues to maintain and improve its system. However, in light of the District's past profligacy the Attorney General cannot in good conscience recommend that the Commission fully adopt Staff's revenue request recommendation or the request in Southern's application. Rather, the Attorney General urges the Commission to rely on the principle of gradualism in setting these rates, especially as the Southern customers are also facing a meter surcharge for the foreseeable future, to be compounded by any additional rate requests. Further, the Attorney General recommends that the Commission adopts the structure of the rate design recommended by Staff, which would somewhat mitigate the impact of higher rates, especially for lower usage customers.

Finally, as to any issue in the Staff Report which the Attorney General did not address in these comments, his silence does not equal his agreement or acquiescence, and should not be taken as such.

WHEREFORE, the Attorney General respectfully requests the Commission, based upon the evidentiary record, set a fair, just, and reasonable rate for the customers of Southern Water and Sewer District. In light of the emergency hearing already held in this case, and the hearing more recently held in a related case, the Attorney General does not believe a hearing is necessary and requests that this case be submitted on the record.

Respectfully submitted,

ANDY BESHEAR  
ATTORNEY GENERAL

A handwritten signature in black ink, appearing to read "Justin McNeil", is written over a horizontal line.

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*Certificate of Service and Filing*

Counsel certifies that an original and ten (10) photocopies of the foregoing were served and filed by hand delivery to Gwen R. Pinson, Executive Director, Public Service Commission, 211 Sower Boulevard, Frankfort, KY 40601; counsel further states that true and accurate copies of the foregoing were mailed via First Class U.S. Mail to:

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This 29<sup>th</sup> day of August 2019.

  
Assistant Attorney General