

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

ORDER

This matter arises from an application for a rate increase filed by Bluegrass Water Utility Operating Company, LLC (Bluegrass Water) pursuant to KRS 278.020(1), KRS 278.180, and KRS 278.190. The Kentucky Attorney General, through the Office of Rate Intervention (Attorney General) and Scott County, Kentucky (Scott County) were permitted to intervene in this matter. Bluegrass Water responded to requests for information from the Attorney General, Scott County, and Commission Staff, and a hearing was conducted in this matter on September 19 2023, through September 20, 2023. Bluegrass Water responded to post-hearing requests for information, all parties filed initial post-hearing briefs and response briefs. This matter is now before the Commission for a decision on the merits.

BACKGROUND

Bluegrass Water is a limited liability company organized under the laws of Kentucky on March 21, 2019. Bluegrass Water is categorized as a class B sewer utility and a class C water utility. Beginning in April 2019, Bluegrass Water began filing applications pursuant to KRS Chapter 278 to purchase water and wastewater systems in Kentucky. Bluegrass Water has now requested a 15 percent rate increase to the

wastewater systems that are on Bluegrass Water's unified wastewater rates, as approved by the Commission in Case No. 2020-00290.<sup>1</sup> This requested relief would result in an increase to the fixed monthly charge from \$85.97 to \$99.37.<sup>2</sup>

In addition to its unified-rate customers, Bluegrass Water currently has five systems that are charged rates under the terms of the tariffs in place when the systems were acquired by Bluegrass Water.<sup>3</sup> Bluegrass Water's wastewater systems that are not currently on the unified wastewater rate are Darlington Creek, Delaplain, Herrington Haven, Springcrest, and Woodland Acres. Bluegrass Water's proposal to move these residential customers to the unified rate would result in the following rate changes:

- a. Darlington Creek: \$45.00 fixed charge to \$99.37 fixed charge, a 120.8 percent increase;
- b. Delaplain: \$12.50 fixed charge to \$99.37 fixed charge, a 695 percent increase;
- c. Herrington Haven: \$49.66 fixed charge to \$99.37 fixed charge, a 100.1 percent increase;
- d. Springcrest: \$27.43 fixed charge to \$99.37 fixed charge, a 262.3 percent increase; and
- e. Woodland Acres: \$19.47 fixed charge to \$99.37 fixed charge, a 410.4 percent increase.<sup>4</sup>

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<sup>1</sup> Case No. 2020-00290, *Electronic Application of Bluegrass Water Utility Operating Company, LLC for an Adjustment of Rates and Approval of Construction* (Ky. PSC Aug. 2, 2021).

<sup>2</sup> Application at 5.

<sup>3</sup> Application at 5-6.

<sup>4</sup> Application at 6.

In addition to residential rates, Bluegrass Water also proposed a rate increase to its multifamily unit rate, which would only affect the Brocklyn system. The proposed rate change to Bluegrass Water's multifamily unit rate would result in a rate increase from a fixed charge of \$64.48 to \$74.53, or a 15.6 percent increase.<sup>5</sup> Bluegrass Water has a commercial rate in effect at the Delaplain system. Bluegrass Water proposed a rate increase to the commercial customers at the Delaplain system to add a fixed monthly charge of \$248.43 and increase the usage charge from \$8.89 per 1,000 gallons to \$14.91 per 1,000 gallons. Based upon average customer usage, this would result in a 90.6 percent increase on the average commercial customer bill.<sup>6</sup> Finally, Bluegrass Water proposed that the fixed non-residential rate of \$214.93 at the Persimmon Ridge system be increased to \$248.43, which would result in a 15.6 percent increase.<sup>7</sup>

Bluegrass Water's application proposes a rate increase based on a 12-month historical test period and requests rates based on a total revenue requirement for sewer customers of \$3,712,623.<sup>8</sup> Bluegrass Water indicated that the revenue requirement represents an increase of \$1,291,491 over projected revenues derived from current rates for the systems Bluegrass Water owns and operates.<sup>9</sup> Bluegrass Water, in support of its application, presented schedules and written testimony from Josiah Cox, Jacob Freeman, Dylan D'Ascendis, Brent Thies, Timothy Lyons, Quentin Watkins, John Spanos, and Todd Thomas. Among other things, Bluegrass Water indicated that the proposed rates are "a

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<sup>5</sup> Application at 6.

<sup>6</sup> Application at 6.

<sup>7</sup> Application at 6.

<sup>8</sup> Application at 11.

<sup>9</sup> Application at 11.

result of necessary investment to ensure the safe, reliable, and environmentally responsible provision of wastewater services in Bluegrass Water’s service area across the Commonwealth. Bluegrass Water’s investments to date have been desperately needed and have improved the services provided to its customers, while simultaneously remedying many environmental issues at the plants Bluegrass Water acquired.”<sup>10</sup>

At the time of its application, Bluegrass Water had two pending certificate of public convenience and necessity (CPCN) applications.<sup>11</sup> Bluegrass Water initially stated in its application that it did not seek to include in its revenue requirement costs to be incurred relating to the two pending CPCN applications, however, it reserved the right to revise its request if final orders were issued approving either of those applications.<sup>12</sup> The Commission denied a CPCN for remote monitoring at 13 locations in Case No. 2022-00216, because the project was already installed, but did grant a deviation from the regulation that requires daily monitoring, which will result in an adjustment and reduction in rates, as discussed below.<sup>13</sup> The Commission granted a CPCN for a treatment system, solids handling system, security fencing, and gravel access road at Delaplain system in Case No. 2022-00104.<sup>14</sup> However, Bluegrass Water did not attempt to include the revenue requirement impacts associated with the Delaplain CPCN in this case. Rather,

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<sup>10</sup> Application at 3.

<sup>11</sup> Case No. 2022-00216, *Electronic Application of Bluegrass Water Utility Operating Company, LLC for Certificate of Public Convenience and Necessity for the Installation of Monitoring Equipment and for a Corresponding Limited Waiver of Daily Inspections* (Ky. PSC Aug. 8, 2022); Case No. 2022-00104, *Electronic Application of Bluegrass Water Utility Operating Company, LLC for Certificates of Public Convenience and Necessity for Projects at the Delaplain Site* (Ky. PSC Mar. 30, 2022).

<sup>12</sup> Application at 2-3.

<sup>13</sup> Case No. 2022-00216, Jan. 12, 2024 Order. On rehearing, a CPCN was granted for a few of the projects that had not been completed.

<sup>14</sup> Case No. 2022-00104, Mar. 30, 2023 Order.

Bluegrass Water stated that it will seek to include that capital investment in a future rate case after the CPCN project is completed.<sup>15</sup>

At the time of its application, Bluegrass Water also had a pending joint application with the city of Mayfield (Mayfield) seeking approval to transfer the Randview system to Mayfield. Bluegrass Water reserved the right to revise its revenue requirement in the event of the approved acquisition to account for the fact that it would no longer incur the operational expenses associated with that system.<sup>16</sup> On May 5, 2022, the Commission approved the sale of the Randview assets to Mayfield and Bluegrass Water confirmed the sale of the Randview system assets to the city of Mayfield was completed on June 20, 2023.<sup>17</sup>

As a result of the Commission's decisions in the aforementioned proceedings, as well as a decrease to insurance expense, Bluegrass Water proposed a \$266,516 reduction to its proposed revenue requirement from \$3,727,085 to \$3,460,569,<sup>18</sup> as discussed below.

On November 1, 2023, Bluegrass Water filed a notice of intent to implement its proposed rates, which were suspended in a previous Commission Order, on April 14, 2023, pending the final Order and subject to refund as required by KRS 278.190. Bluegrass Water stated it would place its proposed rates into effect on December 1, 2023, with the first bills being issued on or after January 1, 2024. By Order issued December

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<sup>15</sup> Rebuttal Testimony of Brent Thies (Thies Rebuttal Testimony) (filed Aug. 11, 2023) at 5.

<sup>16</sup> Application at 3.

<sup>17</sup> Thies Rebuttal Testimony at 5.

<sup>18</sup> Thies Rebuttal Testimony at 5-6.

7, 2023, the Commission noted that, given the Commission’s review of the voluminous record, a final order was not issued by the December 1, 2023 date, when Bluegrass Water indicated it would place rates into effect, and directed Bluegrass Water to maintain its records in such manner as will allow it, the Commission, or any customer to determine the amounts to be refunded, and to whom, in the event a refund is ordered upon final resolution of this matter. The Commission cautioned that, given the adjustments proposed by other parties in this matter and the effects of cases resolved since the application was filed in this case, some of which were acknowledged by Bluegrass Water, the final rates in this matter will likely be lower than those proposed by Bluegrass Water in its application.

#### LEGAL STANDARD

Bluegrass Water filed its application for a rate adjustment pursuant to KRS 278.180 and KRS 278.190. The Commission’s standard of review of a utility’s request for a rate increase is well established. Bluegrass Water is allowed to charge its customers “only ‘fair, just, and reasonable rates.’”<sup>19</sup> Bluegrass Water bears the burden of proof to show that the proposed rate increase is just and reasonable, under KRS 278.190(3).

#### TEST PERIOD

Bluegrass Water proposed the 12-month period ending June 30, 2022, as the test period for determining the reasonableness of its proposed rates. While they object to some of the expenses included and adjustments, none of the intervenors contested the use of this period as the test period. Further, given the timing of Bluegrass Water’s

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<sup>19</sup> KRS 278.030; see also *Pub. Serv. Comm’n v. Com. ex rel. Conway*, 324 S.W.3d 373, 377 (Ky. 2010).

application, the Commission finds that it is reasonable to use the 12-month period ending June 30, 2022, as the test period in this case. Additionally, except as discussed in other sections of this order, the revenues and expenses incurred during that period are neither unusual nor extraordinary.

## REVENUE REQUIREMENT AND ADJUSTMENTS

### RATE BASE

Bluegrass Water proposed a “Total Original Cost Rate Base” with pro forma adjustments for its sewer division of \$6,388,068 based on a historic test period.<sup>20</sup> That \$6,388,068 in rate base consisted of \$5,221,670 in rate base through the end of the forecasted test period and \$760,942 in net rate base additions from pro forma adjustments. Bluegrass Water indicated that the \$5,221,670 in original cost rate base for the historic test period included write-ups of \$607,772 and \$90,683.64 to Delaplain and River Bluffs’ plant in service, respectively, based on what Bluegrass Water argued was the value of the underlying land; a total of \$90,171.27 in write-ups to the historical plant in service for ten systems that Bluegrass Water identified as acquisition adjustments; a valuation totaling \$39,500 for three systems for which Bluegrass Water indicated it was not able to obtain historic book values; and \$1.861 million in what Bluegrass Water argued were acquisition related costs it was entitled to recover as plant in service. Having reviewed the record and being otherwise sufficiently advised, the Commission finds that Bluegrass Water’s proposed rate base is unreasonable and should be reduced as discussed in more detail below.

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<sup>20</sup> Application, Direct Testimony of Brent Thies on Behalf of Bluegrass Water Utility Operating Company, LLC (Thies Direct Testimony), Exhibit BT-14.

### Acquisition Adjustments

Bluegrass Water sought adjustments related to acquisition premiums totaling \$828,127 for the Airview, Brocklyn, Fox Run, Golden Acres, Great Oaks, Kingswood, Lake Columbia, LH Treatment, Persimmon Ridge, Timberland, Delaplain, River Bluffs, Springcrest, Woodland Acres, and Herrington Haven systems.<sup>21</sup> First, Bluegrass Water proposed the following acquisition adjustments to plant in service for what Bluegrass Water acknowledged was the extent to which the purchase of prices of the systems exceeded the net book value:<sup>22</sup>

<b>Service Area</b>	<b>Amount</b>
Airview	5,588.00
Brocklyn	13,865.02
Fox Run	2,689.04
Golden Acres	850.00
Great Oaks	850.00
Kingswood	10,248.21
Lake Columbia	2,689.04
LH Treatment	36,863.15
Persimmon Ridge	16,403.47
Timberland	125.34
<b>Total</b>	<b>90,171.27</b>

Bluegrass Water was not able to obtain any historic book values for three other systems, Springcrest, Woodlawn, and Herrington Haven, so it assigned the following purchase prices to the plant in service balances for the systems and eliminated any accumulated depreciation:<sup>23</sup>

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<sup>21</sup> Thies Direct Testimony at 29 and 30.  $\$90,171 + \$698,456 + \$39,500 = \$828,127$ .

<sup>22</sup> Thies Direct Testimony at 29.

<sup>23</sup> Thies Direct Testimony at 30.

<b>Service Area</b>	<b>Valuation</b>	<b>Amount</b>
Springcrest	Collection Sewer	15,000.00
Woodland Acres	Collection Sewer	10,000.00
Herrington Haven	Collection Sewer	14,500.00
		<b>39,500.00</b>

Finally, for Delaplain and River Bluffs, Bluegrass Water requested to write-up the plant in service for each system by the difference between its purchase price and the net book value of the systems' assets as recorded by the previous owner in the following amounts:<sup>24</sup>

<b>Service Area</b>	<b>Valuation</b>	<b>Amount</b>
Delaplain	Land Appraisal	607,772.00
River Bluffs	Land Appraisal	90,683.64
		<b>698,455.64</b>

Bluegrass Water initially argued that the write-ups for Delaplain and River Bluffs were not acquisition adjustments, but rather, argued that it was adjusting land values that had not been accounted for by the previous owners based on appraised values at the time of purchase.<sup>25</sup> However, in its Post-Hearing Brief, Bluegrass Water identifies these amounts as proposed acquisition adjustments.<sup>26</sup> Bluegrass Water claimed that in several cases, previous owners simply recorded the value of capital improvements, not the value of the underlying land, and through use of its land appraisals, it sought to include the value of the land, including newly acquired easements, which were never included in the

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<sup>24</sup> Bluegrass Water's Post-Hearing Brief (filed Oct. 27, 2023) at 23; Thies Rebuttal Testimony at 10.

<sup>25</sup> Thies Direct Testimony at 29-30.

<sup>26</sup> Bluegrass Water's Post-Hearing Brief at 21.

books and records.<sup>27</sup> Bluegrass Water claimed that in an attempt to not overstate the property values, “the land appraisals use prorated values, not the full market value and therefore [it is] not attempting to include a market value in rate base.”<sup>28</sup> Bluegrass Water further claimed that, even though the surveys appraise easements and owned-property separately, easements are essential utility property, and inclusion of the prorated, appraised property values is appropriate.<sup>29</sup>

Bluegrass Water asserted that, under the “Delta Test,” the Commission must perform its analysis from the standpoint as though the prior owner had properly operated the system, including making necessary investments.<sup>30</sup> Bluegrass Water cited to the circumstances giving rise to the approval of the acquisition in the *Delta* proceeding, upon which the Commission authorized Delta Natural Gas to recover an acquisition adjustment:

At the time Delta purchased Gas Service Co., the service was substandard. Poorly constructed and inadequately maintained gas lines had severe leakage problems and service was unreliable. Delta had been encouraged by the Commission to acquire Gas Service Co. and, as a part of its application to acquire Gas Service Co., Delta made a commitment to invest heavily in upgrading the facilities to [e]nsure a reliable gas supply for its consumers. . . . The primary evidence in support of the acquisition adjustment presented by Delta is the improved quality of service. The Commission cannot disagree with Delta’s contention that safety and reliability of gas service in the acquired area has improved substantially. Delta has done a commendable job in renovating and operating the acquired system. In this instance, the Commission is of the opinion that Delta has proven that the overall operations and financial condition of the utility have benefits as a result of its acquisition and it

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<sup>27</sup> Bluegrass Water’s Post-Hearing Brief at 23.

<sup>28</sup> Bluegrass Water’s Post-Hearing Brief at 23; Thies Rebuttal Testimony at 10.

<sup>29</sup> Bluegrass Water’s Post-Hearing Brief at 23.

<sup>30</sup> Bluegrass Water’s Post-Hearing Response Brief at 16.

should be allowed a return on its full investment, including the plant acquisition adjustment. Therefore, the Commission will include the plant acquisition adjustment in rate base and allow the amortization of the plant acquisition adjustment in determining the cost of service and revenue requirements herein.<sup>31</sup>

Bluegrass Water stated that the circumstances presented in the *Delta* proceeding are virtually indistinguishable from the facts presented here: the systems purchased by Bluegrass Water suffered from severe operational problems that created service issues; the Engineering Reports presented in this proceeding and the history of environmental compliance of each of the systems speak for themselves; and Bluegrass Water has committed significant time and investment in Kentucky communities to ensure that wastewater services may be provided in a safe and reliable manner that complies with environmental regulations.<sup>32</sup>

Bluegrass Water advocated that it necessarily costs more to operate a system correctly than it does to allow a system to fall into disrepair and out of compliance with environmental regulations,<sup>33</sup> and that, under the overarching policy evinced by the *Delta* decision, for all of the subject acquisitions, it has met the criteria either under the “Delta

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<sup>31</sup> Bluegrass Water’s Post-Hearing Response Brief (filed Nov. 10, 2023) at 17-18, citing to Case No. 9059, *In the Matter of: An Adjustment of Rates of Delta Natural Gas Company, Inc.* (Ky. PSC Sept. 11, 1985) Order at 5, available at: [https://psc.ky.gov/order\\_vault/Orders\\_1980-1988/Orders\\_1985/19009059\\_09111985.pdf](https://psc.ky.gov/order_vault/Orders_1980-1988/Orders_1985/19009059_09111985.pdf); Case No. 2020-00396, *In the Matter of: Electronic Application of Navitas Ky NG, Johnson County Gas Company, and B&H Gas Company for Approval of Acquisition, Transfer of Ownership, and Control of Natural Gas Utility Systems*, (Ky. PSC Apr. 27, 2021) (“The acquisition is expected to result in overall benefits in the financial and service aspects of the operation of B&H and Johnson County. The Commission expects Navitas KY’s operation of these systems to reduce costs, improve safety, and increase regulatory compliance. Therefore, the Commission finds that Navitas KY has satisfied the requirements of the Delta Test.”).

<sup>32</sup> Bluegrass Water’s Post-Hearing Response Brief at 18.

<sup>33</sup> Bluegrass Water’s Post-Hearing Response Brief at 16.

Test” for the systems acquired prior to June 2021, or KRS 278.295, which codified those factors for the acquisitions after June 2021.<sup>34</sup> Bluegrass asserted: (1) all acquisitions were negotiated and finalized based upon arms-length negotiations; (2) the impact on rates from the requested adjustment is only 2.7 percent; (3) the purchase by Bluegrass Water has created numerous benefits and economies of scale, including the cost savings from operational contractors and additional services provided by Bluegrass Water; (4) Bluegrass Water did not purchase any nonutility property in any acquisition; and (5) Bluegrass Water’s purchase of the systems has resulted in numerous financial and service benefits to the ratepayers, including the addition of new services, as well as the compliance remedies that have added to the ratepayer’s services.<sup>35</sup>

Both the Attorney General and Scott County objected to the use of land appraisals in requesting the acquisition adjustments. The Attorney General argued that all acquisition adjustments should be excluded,<sup>36</sup> while Scott County argued for the exclusion of only Delaplain’s acquisition adjustment.<sup>37</sup>

The Attorney General argued there is no evidence in the record that ratepayers have benefited financially from Bluegrass Water’s acquisition of these systems.<sup>38</sup> The Attorney General stated Bluegrass Water cannot simultaneously request a 53 percent increase to base rates, with ratepayers who have sustained massive rate increases, and will experience even more if the current proposal is adopted, while at the same time

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<sup>34</sup> Bluegrass Water’s Post-Hearing Response Brief at 17.

<sup>35</sup> Bluegrass Water’s Post-Hearing Brief at 22.

<sup>36</sup> Attorney General’s Post-Hearing Brief (filed Oct. 27, 2023) at 10-11.

<sup>37</sup> Scott County’s Memorandum Brief (filed Oct. 27, 2023) at 10-15.

<sup>38</sup> Attorney General’s Post-Hearing Brief at 10.

represent it meets a standard that, “the initial investment plus the cost of restoring the facilities to required standards will not adversely impact the overall costs and rates of the existing and new customers.”<sup>39</sup> The Attorney General further stated that Bluegrass Water has failed to make a comparison of how its legal, accounting, human resources, customer service, and business services compare to the cost of those services under previous ownership and it is impossible to know if “operational economies” are being achieved without such an analysis.<sup>40</sup> The Attorney General also pointed out that rates have only increased since the acquisitions and any economies achieved have yet to accrue demonstrably to the benefit of ratepayers.<sup>41</sup> Lastly, the Attorney General argued it is bad policy to allow Bluegrass Water to be reimbursed for the market value of its acquisition of the systems; urging that, if the Commission were to allow such recovery, purchasers of systems would lack appropriate incentives to minimize the purchase price paid for such assets.<sup>42</sup> The Attorney General asserted that negative cost effects of such poor decision-making would be directly borne by ratepayers, not the utility owners positioned to control those costs.<sup>43</sup>

Scott County argued that Bluegrass Water failed to meet several of the “Delta Test” criteria for the proposed write-up to the Delaplain system. Firstly, Scott County claimed that the purchase price for Delaplain is excessive and not the product of an arms-length negotiation, as the transaction was structured differently than the other acquisitions,

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<sup>39</sup> Attorney General’s Post-Hearing Brief at 9-10.

<sup>40</sup> Attorney General’s Post-Hearing Brief at 10.

<sup>41</sup> Attorney General’s Post-Hearing Brief at 10.

<sup>42</sup> Attorney General’s Post-Hearing Brief at 10.

<sup>43</sup> Attorney General’s Post-Hearing Brief at 10.

including an amount to replace the personal income stream of an owner, and in a manner to accommodate the prior owner's tax concerns.<sup>44</sup> Scott County argued that compensation to the prior owner as a service provider results in a relationship between a vendor and the utility and compensating a utility's vendor's income stream for service that will no longer be provided by that vendor is not the responsibility of the ratepayers.<sup>45</sup>

Scott County also argued Bluegrass Water failed to demonstrate that "the initial investment plus the cost of restoring the facilities to the required standards will not adversely impact the overall costs and rates of the existing and new customers."<sup>46</sup> Scott County emphasized the initial investment for Delaplain, which includes the premium of \$629,772 (payment above net book value using original costs), represents over 10 percent of Bluegrass Water's proposed total [stated] original cost rate base of \$6,257,170 in this case. Scott County pointed to Commission precedent, cautioning that "Acquisition adjustments must be approached with caution to ensure that rates are not artificially inflated by excessive sales premiums."<sup>47</sup> Scott County stated the investment and cost of restoration to the Delaplain system necessarily adversely impacts overall costs and rates of existing and new customers, as it failed to meet its burden to demonstrate that the premium paid plus the cost of restoration does not exceed "what otherwise could have been incurred by the utility to remedy its operating deficiencies."<sup>48</sup>

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<sup>44</sup> Scott County's Memorandum Brief at 12-13.

<sup>45</sup> Scott County's Memorandum Brief at 13.

<sup>46</sup> Scott County's Memorandum Brief at 13.

<sup>47</sup> See Case No. 2004-00103, *Adjustment of the Rates of Kentucky-American Water Company*, (Ky. PSC Feb. 28, 2005), Order at 4-10 (finding and concluding that acquisitions of systems with deficiencies failed "Delta Test").

<sup>48</sup> Scott County's Memorandum Brief at 13-14.

Scott County asserted there is a strong policy argument, upon review of cases applying the “Delta Test,” that the recovery of an acquisition adjustment serves primarily to provide an incentive for a company to acquire assets that are outside of its business model.<sup>49</sup> However, Scott County stated the Commission has previously recognized Bluegrass Water purchases distressed systems as part of its normal business and the acquisition of Delaplain was wholly consistent with its business model and, likewise, Bluegrass Water accepted the risk for which it seeks compensation for that risk through its return on equity.<sup>50</sup>

Scott County further argued that Bluegrass Water failed to meet the requirement that the purchase price of utility property is clearly identified, given that the purchase price for the assets of the Delaplain system was determined through a unique structure to allocate the purchase price favorably to the prior owner. Scott County claimed that Bluegrass Water’s decision to write-up its land and land rights accounts based upon an appraisal also demonstrates that the purchase price of utility property is not clearly identified within the meaning of the Delta Test, as Bluegrass Water argued alternatively that the cost of certain utility assets is unknown and must be separately valued through an alternative means, yet thereafter maintained (for purposes of the “Delta Test”) that it clearly identified the purchase price of the same utility property. Scott County stated that, in regards to this “Delta Test” criteria, Bluegrass Water demonstrated only that it paid an amount in excess of the original cost of the assets. “Acquisition adjustments must be

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<sup>49</sup> Scott County’s Memorandum Brief at 14.

<sup>50</sup> Scott County’s Memorandum Brief at 15.

approached with caution to ensure that rates are not artificially inflated by excessive sales premiums.”<sup>51</sup>

Pursuant to KRS 278.290, the Commission may fix the value of a utility’s property in order to determine the legality or reasonableness of any rate.<sup>52</sup> KRS 278.295(2), which was enacted in 2021, states:

[I]n any matter in which the commission determines for ratemaking purposes the value of an asset used to provide water or sewer service acquired by a utility from a water or sewer system, the commission shall fix the value of that asset at an amount between its net original cost and its asset acquisition price without regard for the original source of funds used to procure the asset, but only if the acquiring utility demonstrates and the commission finds that:

- (a) The asset acquisition price was established by arms-length negotiations;
- (b) The asset acquisition price plus the cost of restoring the acquired facilities to required standards will not materially adversely impact the overall costs or rates of the acquiring utility's existing and new customers;
- (c) Acquisition of the asset will result in operational economies;
- (d) The purchase prices of the utility and non-utility assets are clearly identified, and where practical, separated; and
- (e) The acquisition will result in overall financial and service benefits of the acquiring utility's operations.

KRS 278.295(2) codified the “Delta Test,” which the Commission adopted in Case No. 9059 and has applied ever since to determine whether a utility may make an adjustment to its plant to account for the purchase of plant at a price in excess of the net

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<sup>51</sup> See Case No. 2004-00103, *Adjustment of the Rates of Kentucky-American Water Company* (Ky. PSC Feb. 28, 2005), Order at 4-10 (finding and concluding that acquisitions of systems with deficiencies failed “Delta Test”).

<sup>52</sup> KRS 278.290(1) and (2).

original cost of the assets purchased.<sup>53</sup> Specifically, to establish that it is entitled to such an acquisition adjustment, the “Delta Test” required that a utility establish that:

[T]he purchase price was established upon arms-length negotiations, the initial investment plus the cost of restoring the facilities to required standards will not adversely impact the overall costs and rates of the existing and new customers, operational economies can be achieved through the acquisition, the purchase price of utility and non-utility property can be clearly identified, and the purchase will result in overall benefits in the financial and service aspects of the utility’s operations.<sup>54</sup>

Since the Order establishing the Delta Test,<sup>55</sup> the Commission has considered plant acquisition adjustments on a case-by-case basis and allowed recovery only when the record demonstrated that the consumers are benefited by the acquisition.<sup>56</sup> The Commission has maintained its position that the net original cost of plant devoted to utility use is the fair value for rate-making purposes, unless there is conclusive evidence that the overall operations and financial condition of the utility have benefited from the acquisition at a price in excess of the net book value.<sup>57</sup>

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<sup>53</sup> Case No. 9059, *An Adjustment of the Rates of Delta Natural Gas Company, Inc.*, (Ky. PSC Sept. 11, 1985), Order at 3.

<sup>54</sup> See Case No 2020-00396, *Electronic Application of Navitas Ky Ng, Johnson County Gas Company, and B & H Gas Company for Approval of Acquisition, Transfer of Ownership, and Control of Natural Gas Utility Systems* (Ky. PSC Apr. 27, 2021) Order at 10-11.

<sup>55</sup> Case No. 9059, Sept. 11, 1985 Order at 3.

<sup>56</sup> Case No. 9059, Sept. 11, 1985 Order at 5; see also Case No. 2020-00396, *In the Matter of: Electronic Application of Navitas Ky NG, Johnson County Gas Company, and B&H Gas Company for Approval of Acquisition, Transfer of Ownership, and Control of Natural Gas Utility Systems* (Ky. PSC Apr. 27, 2021) (“The acquisition is expected to result in overall benefits in the financial and service aspects of the operation of B&H and Johnson County. The Commission expects Navitas KY’s operation of these systems to reduce costs, improve safety, and increase regulatory compliance. Therefore, the Commission finds that Navitas KY has satisfied the requirements of the Delta Test.”); Case No. 2004-00103, *Adjustment of the Rates of Kentucky American Water Company* (Ky. PSC Feb. 28, 2005) Order at 4-10 (finding and concluding that acquisitions of systems with deficiencies failed Delta Test).

<sup>57</sup> Case No. 9059, Sept. 11, 1985 Order.

As an initial matter, the Commission disagrees with Bluegrass Water, at least in part, that KRS 278.295 is not applicable to its proposed valuations. In substance, KRS 278.295(2) simply establishes how the Commission is required to fix the value of assets purchased by a utility at a price in excess of its net original cost “in any matter in which the commission determines for ratemaking purposes the value of an asset.”<sup>58</sup> There is no question that KRS 278.295(2) is currently effective and that this is a matter in which the Commission determines the value of assets for ratemaking purposes. Further, there has been no evidence that the Commission previously addressed the value of the assets involved under a different standard or would otherwise be precluded from applying the substantive standards in KRS 278.295 at this point. Thus, KRS 278.295(2) applies to each of Bluegrass Water’s proposals to establish values for purchased assets in excess of the net original cost of the assets. However, if KRS 278.295(2) did not apply, the Delta Test would result in the application of the same criteria to determine whether Bluegrass Water is entitled to an acquisition adjustment.

With respect to the proposed valuation of Delaplain and River Bluffs’ assets, the Commission disagrees with Bluegrass Water that its adjustment for the alleged property values of the Delaplain and River Bluffs systems should not be treated as an acquisition adjustment (Bluegrass Water may now concede that its proposed write-ups of the Delaplain and River Bluff systems should be treated as acquisition adjustments as it argues why they meet that standard).<sup>59</sup> The NARUC Uniform System of Accounts

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<sup>58</sup> KRS 278.295(2). There are new procedural rules included in KRS 278.295(2), some of which may not apply retroactively, but those are not relevant to the substantive requirements.

<sup>59</sup> Bluegrass Water Post-Hearing Brief at 21 (includes these proposals under its discussion requesting acquisition adjustments be approved).

(USoA), which was adopted by the Commission and is generally applied by water and sewer utilities in Kentucky, indicates that the original cost of utility plant may be estimated where it is unknown when determining whether an acquisition adjustment is needed.<sup>60</sup> While KRS 278.295 does not specifically state that it is permissible to estimate the original cost of utility plant, it does not explicitly prohibit it. However, both KRS 278.295 and the USoA contemplate that the original cost is referring to the original cost of the first person who devoted the property to utility service.<sup>61</sup>

The appraisals obtained by Bluegrass Water for the alleged value of land for Delaplain and River Bluffs make no attempt to estimate the original cost of the Land and Land Rights to the owner that first devoted them to utility service. Further, even if the appraisals claimed to estimate the original cost of the Land and Land Rights, the Commission would not find them particularly credible, because they are based on the current value of developed property in the areas served, e.g. the value of a lot in the River Bluffs neighborhood,<sup>62</sup> but the construction of infrastructure such as the sewer systems at issue would have been a precondition of development, so it would be illogical to use the current value of developed property to identify the original cost. Additionally,

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<sup>60</sup> Nation Association of Regulatory Utility Commissions, Uniform System of Accounts Class A/B Water Companies (available at <https://psc.ky.gov/agencies/psc/forms/usoA/0600ab02.pdf>) (lasted assessed Feb. 9, 2024) at page 25 (“The original cost of plant, estimated if not known, shall be credited to account 104 - Utility Plant Purchased or Sold, and concurrently charged to the appropriate utility plant in service accounts.”).

<sup>61</sup> See Uniform System of Accounts Class A/B Water Companies at page 12 (“‘Original cost’, as applied to utility plant, means the cost of such property to the person first devoting it to public service.”).

<sup>62</sup> The Commission also notes that the appraisals estimated the value of the land rights assuming that there were no upgrades to the land. However, as Bluegrass Water’s witnesses noted when discussing the negative net salvage value, there is a cost to restoring property previously used to provide sewer service to be used for other purposes. Thus, while the plant used to provide service has value, the current value of the land rights would not be the same as the same rights on unimproved land.

Bluegrass Water's claims that the original costs assigned to the Land and Land Rights by the previous owners must be incorrect because either no or a low value was recorded in that account; however, the Commission disagrees, because as noted above, the areas served needed sewer service to develop such that it is likely that the previous owners of the systems obtained favorable terms on Land and Land Rights for the systems. Notably, according to the numbers provided by Bluegrass Water, the previous owner of nearly every system it purchased assigned low values to land rights. Thus, having reviewed the record and being otherwise sufficiently advised, the Commission agrees with Scott County and the Attorney General that the write-up for the alleged value of the land and easement rights that Bluegrass Water has requested to recover for Delaplain and River Bluffs should be treated as an acquisition adjustment and analyzed pursuant to the criteria set forth under the "Delta Test" and KRS 278.295,<sup>63</sup> because Bluegrass Water is seeking to write-up the value of Delaplain and River Bluffs assets based on purchase prices in excess of the net original cost of the assets as recorded by the original owner.

Bluegrass Water failed to establish that the write-up to the Delaplain and River Bluffs systems meet the elements of the Delta Test and KRS 278.295. Bluegrass Water reported that the book cost of the Delaplain system at the time of acquisition, including Bluegrass Water's proposed acquisition adjustment, was \$849,000,<sup>64</sup> which means that Bluegrass Water's proposed acquisition adjustment of \$607,772 for Delaplain represents more than a 250 percent increase in the net original book cost of Delaplain's assets as

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<sup>63</sup> Testimony of David Dittmore (Dittmore Testimony) (filed June 30, 2023) at 15.

<sup>64</sup> Bluegrass Water's Response to Commission Staff's Third Request for Information (Staff's Third Request) (filed June 22, 2023), Item 9, Exhibit\_PSC\_3-9\_-\_Plant\_in\_Service\_Breakdown.xlsx, Tab Acquisition.

recorded by the previous owner.<sup>65</sup> In fact, the proposed acquisition adjustment for Delaplain alone represents about 10 percent of Bluegrass Water's proposed Total Original Cost Rate Base of \$6,257,170 in this case, even including all of Bluegrass Water's additions and write-ups to its rate base.<sup>66</sup> Bluegrass Water similarly reported that the book cost of the River Bluffs system at the time of acquisition, including Bluegrass Water's proposed acquisition adjustment, was \$272,433.90,<sup>67</sup> which means that Bluegrass Water's proposed acquisition adjustment of \$90,683.64 for River Bluffs represents about a 50 percent increase in the net original book cost of River Bluffs' assets as recorded by the previous owner.<sup>68</sup> At the rate of return proposed by Bluegrass Water, the write-ups for supposed land values the Delaplain and River Bluff's systems alone would increase the revenue requirement for Bluegrass Water by about \$68,449 per year (not including the gross up for taxes).<sup>69</sup> Even accepting Bluegrass Water's premise that the Commission should look at savings from economies of scale as if the systems had been operated appropriately before the sale, there is no evidence that Bluegrass Water's purchase of the Delaplain and River Bluffs systems led to such significant annual savings. In fact, at the hearing in this matter, Bluegrass Water's President acknowledged that its

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<sup>65</sup>  $\$849,000 - \$607,772 = \$241,228$ ;  $\$607,772 / \$241,228 = 252\%$ .

<sup>66</sup> See Scott County's Memorandum Brief at 12-14. Some of Bluegrass Water's additions and write-ups to its total original cost rate base are unsupported or unreasonable for the reasons discussed below. With those additions or write-ups removed, Bluegrass Water's proposed acquisition adjustments makes up an even larger portion of its total original cost rate base.

<sup>67</sup> Bluegrass Water's Response to Staff's Third Request, Item 9, Exhibit\_PSC\_3-9\_-\_Plant\_in\_Service\_Breakdown.xlsx, Tab Acquisition.

<sup>68</sup>  $\$272,433.90 - \$90,683.64 = \$181,749$ ;  $\$90,683.64 / \$272,433.90 = 49.9\%$ .

<sup>69</sup>  $\$698,456 \times 9.8\% = \$68,448.69$

customers are unlikely to see significant savings from economies of scale until Bluegrass Water engages in further expansion.<sup>70</sup>

More importantly, while it is possible that Bluegrass Water was or will be able to remedy the operating deficiencies at the Delaplain and River Bluffs systems at a lower cost than previous owners and operators, Bluegrass Water did not present evidence to support such savings. In fact, given the size of the acquisition adjustments proposed by Bluegrass Water for Delaplain and River Bluffs, it is implausible that Bluegrass Water's purchase of the systems generated such savings as the premiums paid for Delaplain and River Bluffs represent a significant portion of the cost of improvements Bluegrass Water has made or currently has planned for the systems.<sup>71</sup> Thus, having reviewed the record and being otherwise sufficiently advised, the evidence presented by Bluegrass Water in this case regarding the acquisition adjustments for Delaplain and River Bluffs did not establish that the initial investment plus the cost of restoring the facilities to required standards will not adversely impact the overall costs and rates of the existing and new customers, and therefore, the Commission finds that Bluegrass Water's proposed adjustments to Delaplain and River Bluffs' plant in service in the amounts of \$607,772 and \$90,684, respectively, should be rejected.

With respect to the ten systems listed above for which Bluegrass Water requests an acquisition adjustment totaling \$90,171.27, the Commission finds that the proposed write-ups meet the elements of the Delta Test and KRS 278.295. First, there is no

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<sup>70</sup> Hearing Video Transcript (HVT) of the Sept. 19, 2023 Hearing at 04:58.

<sup>71</sup> See Bluegrass Water's Response to Staff's Third Request, Item 9, Exhibit\_PSC\_3-9\_-\_Plant\_in\_Service\_Breakdown.xlsx, Tab Acquisition (indicating about \$293,000 in post-acquisition improvements for River Bluffs and about \$63,954 in post-acquisition improvements for Delaplain); Thies Direct Testimony at 26 (indicating \$609,900 in planned projects at Delaplain).

evidence that Bluegrass Water had any relationship with the previous owners of the systems or that the purchases were anything other than arms-length transactions. Second, while the evidence regarding cost savings generated by Bluegrass Water's acquisition of these systems is relatively weak, Bluegrass Water's proposed acquisition adjustments for these ten systems are relatively modest such that the Commission finds that customers of those systems will ultimately be better off even with the acquisition adjustments. The purchase prices of the utility and non-utility assets can also be clearly identified. Thus, the Commission finds that Bluegrass Water's proposed acquisition adjustments totaling \$90,171.27 for Airview, Brocklyn, Fox Run, Golden Acres, Great Oaks, Kingswood, Lake Columbia, LH Treatment, Persimmon Ridge, and Timberland are reasonable and should be accepted.

The Commission similarly finds that Bluegrass Water's proposed adjustments to Springcrest, Woodland Acres, and Herrington Haven's acquisition date plant in service should be accepted. Unlike Delaplain and River Bluffs, the previous owners of Springcrest, Woodland Acres, and Herrington Haven, which were not utilities regulated by the Commission, did not maintain any records of the original cost of plant in service or accumulated depreciation such that the adjustments proposed by Bluegrass Water represent the total acquisition date rate base for those three systems. The total amount Bluegrass Water proposed to assign to acquisition date net plant in service for those systems is also a reasonable estimate of the original cost, net plant in service for those systems based on the net plant in service for Bluegrass Water's other systems. Thus, the Commission finds that Bluegrass Water's proposed adjustment to the net plant in service

of Springcrest, Woodland Acres, and Herrington Haven in the amounts of \$15,000, \$10,000, and \$14,500, respectively, are reasonable and should be accepted.

The removal of the acquisition adjustments in the amount of \$607,772 and \$90,684 for the Delaplain and River Bluffs systems result in a decrease in the revenue requirement in the amount of about \$73,964 and \$11,036, respectively, based on the return proposed by Bluegrass Water, grossed up as proposed by Bluegrass Water. Notably, the removal of the acquisition adjustments does not result in a change in depreciation or amortization expense, because Bluegrass Water did not include depreciation or amortization for the adjustments as it assigned the values to Land and Land Rights, which does not depreciate or amortize.

#### Acquisition Related Costs – Attorney Fees.

In the application, Bluegrass Water calculated the utility plant in service, prior to a pro forma adjustment, as including acquisition related expenses.<sup>72</sup> Bluegrass Water stated the acquisition related costs total \$1,861,351 for the systems included in this filing. These costs include closing costs incurred as part of the purchase process, fees paid to real estate attorneys, costs associated with survey and mapping professionals, engineering costs, and legal fees incurred as part of the regulatory process for obtaining approval of the acquisitions. Bluegrass Water provided spending details which Commission Staff summarized into the cost categories below.<sup>73</sup>

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<sup>72</sup> Thies Direct Testimony at 22.

<sup>73</sup> Bluegrass Water's Response to Attorney General's First Request of Information (Attorney General's First Request) (filed May 12, 2023) Item 128, Exhibit\_OAG\_1-128\_-\_Acquisition\_Related\_Cost\_Final.xlsx, Listing of Assets. Bluegrass Water's Response to Attorney Generals Second Request, (Jun. 16, 2023), Item 73, Acquisition Related Cost Tab.

<u>Expense Categories</u>	<u>Amount</u>
Legal Fees	\$ 1,117,482
Engineering Expenses	452,767
Operations & Maintenance Expenses	143,546
Closing Costs	64,547
Right of Way Services	32,678
Other Vendors	32,658
Billing Expenses	7,733
Easement Costs	5,000
Appraisals Costs	2,500
Material Costs	<u>2,440</u>
 Total Acquisition Related Costs	 <u><u>\$1,861,351</u></u>

Bluegrass Water’s primary accounting witness, Brent Thies, was asked at the hearing what standard allowed for the capitalization of these costs.<sup>74</sup> Mr. Thies testified that Bluegrass Water booked the costs to Account 183, Preliminary Survey and Engineering in the USoA, or 186 in the 1996 version of the USoA.<sup>75</sup> Mr. Thies stated Account 183 is used as a holding account to “park” the acquisition expenses into until the purchase of the system is finalized, but claimed that it does not include Business Development expenses.<sup>76</sup> Mr. Thies stated that the acquisition related costs are usually transferred from Account 183 to the appropriate utility plant in service account within 90 to 120 days of the closing of the purchase, in order to have all the invoices collected and the costs accounted for.<sup>77</sup> Mr. Thies stated that the transfer of expenses occurs with the

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<sup>74</sup> HVT of the Sept. 19, 2023 Hearing at 07:49:12.

<sup>75</sup> HVT of the Sept. 19, 2023 Hearing at 07:49:30.

<sup>76</sup> HVT of the Sept. 19, 2023 Hearing at 07:52:15.

<sup>77</sup> HVT of the Sept. 19, 2023 Hearing at 08:00:40.

completion of the purchase, not the beginning of construction related to the system since every system they purchase is expected to require major repairs.<sup>78</sup>

At the hearing, a version NARUC Account 183 for Class A-B Utilities, was read into the record as stating the following:<sup>79</sup>

This account shall be charged with all expenditures for preliminary surveys, plans, investigations, etc. made for the purpose of determining the feasibility of project under contemplation. If construction results, this account shall be credited and the appropriate utility plant account charged. If the work is abandoned, the charge shall be to account 426 - Miscellaneous Nonutility Expenses, or to the appropriate operating expense account unless otherwise ordered by the Commission (See account 675 - Miscellaneous Expenses).

The records supporting the entries to this account shall be so kept that the utility can furnish complete information as to the nature and the purpose of the survey, plans, or investigations and the nature and amounts of the several charges. Note:-- The amount of preliminary survey and investigation charges transferred to utility plant shall not exceed the expenditures which may reasonably be determined to contribute directly and immediately and without duplication to utility plant.

Mr. Thies acknowledged that was the standard he was relying on to book what Bluegrass Water referred to as the acquisition related expenses into NARUC Account 183 before capitalizing them as part of plant in service.<sup>80</sup>

Mr. Thies acknowledged at the hearing that the closing of the acquisition for new assets is not the project referred to in the language of Account 183, rather the preliminary work provides Bluegrass Water with a sense of what projects need to happen and when

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<sup>78</sup> HVT of the Sept. 19, 2023 Hearing at 08:01:51.

<sup>79</sup> HVT of the Sept. 19, 2023 Hearing at 08:03:21; Uniform System of Accounts Class A/B Water Companies at page 69-70 (showing account 183).

<sup>80</sup> See HVT of the Sept. 19, 2023 Hearing at 08:03:21-08:08:04.

and where based on analysis pre-acquisition.<sup>81</sup> If Bluegrass Water does not make improvements to a system, Mr. Thies indicated that the costs would be written-off.<sup>82</sup>

In post-hearing requests for information, Bluegrass Water was asked to provide the “standard for NARUC Account 183 that Brent Thies referred to at the hearing as supporting the capitalization of [acquisition related] costs.”<sup>83</sup> Bluegrass Water responded by quoting a portion of the NARUC Account stating:

This account shall be charged with all expenditures for preliminary surveys, plans, investigations, etc. made for the purpose of determining the feasibility of project under contemplation. If construction results, this account shall be credited and the appropriate utility plant account charged.<sup>84</sup>

Contrary to Mr. Thies’ testimony at the hearing, Bluegrass Water then asserted, among other things, that:

[f]or purposes of applying the NARUC account instructions, the “project under contemplation” is the acquisition of the system in question and the resulting projects the engineering assessments of the systems reflect are needed to safely and reliably operate the systems purchased.<sup>85</sup>

In post-hearing briefing, Bluegrass Water argued that it should be permitted to include the acquisition related costs in plant in service, because the costs were incurred for the benefit of Bluegrass Water’s customers and because doing so is consistent with

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<sup>81</sup> HVT of the Sept. 19, 2023 Hearing at 08:05:21.

<sup>82</sup> HVT of the Sept. 19, 2023 Hearing at 08:06:30.

<sup>83</sup> Bluegrass Water’s Response to Commission Staff’s Post Hearing Requests for Information (Staff’s Post-Hearing Requests) (filed Oct. 6, 2023), Item 5.

<sup>84</sup> Bluegrass Water’s Response to Staff’s Post Hearing Requests, Item 5.

<sup>85</sup> Bluegrass Water’s Response to Staff’s Post Hearing Requests, Item 5.

the USoA.<sup>86</sup> Bluegrass Water stated that it first “places acquisition related costs in Account 183 as they are incurred, and if the acquisition is approved by the Commission, Bluegrass Water moves the costs from Account 183 in compliance therewith.”<sup>87</sup> Bluegrass Water again argued that “for purpose of applying the NARUC account instructions, [the] ‘project under contemplation’ [(as used in Account 183)] is the acquisition of the system in question and the resulting projects the engineering assessments of the systems reflect are needed to safely and reliably operate the systems purchased.”<sup>88</sup>

The Commission disagrees with the argument Bluegrass Water made in response to Post-Hearing Requests for Information and in its brief that the acquisition is the project under contemplation referred to in Account 183. First, Mr. Thies acknowledged at the hearing that the closing of the acquisition for new assets is not the project referred to in the language of Account 183. A reading that the acquisition is the project under contemplation is also inconsistent with the account description, which refers to “construction result[ing]” and uses the term project. The term “project” is also often used to refer to planned construction, and while it might potentially be used to refer to an acquisition, that would be an unusual usage, especially considering the fact that other provisions of the USoA specifically use the term “acquisition” when discussing costs associated with acquisitions.<sup>89</sup> Thus, the Commission finds that the term “project”

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<sup>86</sup> Bluegrass Water’s Post-Hearing Brief at 17, *citing to* National Association of Regulatory Utility Commissioners, Uniform System of Accounts for Class A/B Water Districts and Associations (available at <https://psc.ky.gov/agencies/psc/forms/usoa/0700ab02.pdf>) (last accessed Feb. 9, 2024).

<sup>87</sup> Bluegrass Water’s Post-Hearing Brief at 17.

<sup>88</sup> Bluegrass Water’s Post-Hearing Brief at 17.

<sup>89</sup> See Uniform System of Accounts Class A/B Water Companies at 25.

referred to in Account 183 is most reasonably read as referring to a project to construct plant such that Account 183 would not allow for capitalization of purely acquisition related costs.

In fact, the USoA appears to contemplate that “the costs of acquisition, including expenses incidental thereto properly includible in utility plant,” should be initially charged to Account 104 before being charged to the appropriate plant accounts or treated as an acquisition adjustment.<sup>90</sup> The Commission also notes that to the extent a utility is attempting to assign acquisition related costs to the value of assets acquired by a utility, which is what Bluegrass Water stated is occurring and what would naturally occur if the acquisition were the project referred to in Account 183, that KRS 278.295 would similarly treat such an assignment of value as an acquisition adjustment, because KRS 278.295(2) applies “in any matter in which the commission determines for ratemaking purposes the value of an asset used to provide water or sewer service acquired by a utility from a water or sewer system.”<sup>91</sup>

Bluegrass Water stated that the \$1,117,482 in attorney fees included in acquisition related costs were for the regulatory and real estate attorneys doing work to get Bluegrass Water ready to take over ownership and operation of the systems it was purchasing<sup>92</sup>— a review of the invoices similarly indicates that the bulk of the work was related to real estate and regulatory work associated with the purchase. The Commission does not believe that such work can reasonably be tied to future construction projects at the

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<sup>90</sup> Uniform System of Accounts Class A/B Water Companies at 25-26.

<sup>91</sup> KRS 278.295(2).

<sup>92</sup> HVT of the Sept. 19, 2023 Hearing at 08:06:30.

systems that would allow such costs to be moved to plant in service upon completion of the project, and there has been no evidence or argument presented that would support including those costs as an acquisition adjustment. Thus, the Commission finds that Bluegrass Water failed to establish that the \$1,117,482 in legal costs recorded in plant in service pursuant to Account 183 should be included in plant in service, and therefore, the Commission finds that that amount should be removed from plant in service.<sup>93</sup>

The removal of the \$1,117,482 from plant in service also requires the removal of \$40,945 from accumulated depreciation to account for the extent to which those costs were depreciated after being added to plant in service.<sup>94</sup> Thus, the removal results in a net change in rate base of \$1,076,537. This adjustment reduces Bluegrass Water's return, grossed up in the manner proposed by Bluegrass Water, by about \$137,357, and

<sup>93</sup> The Commission also questions the reasonableness of the expenses given the amount of the expense involved as compared to the value of the assets at issue.

<sup>94</sup> To estimate the accumulated depreciation, the Commission divided the attorney fees into groups based on the date that Bluegrass Water indicated that they were placed in service. The Commission then applied the depreciation rates proposed by Bluegrass Water to each group to obtain an estimate of the annual depreciation and divided that annual depreciation by 12 to obtain an estimate of the monthly depreciation. The Commission then multiplied the monthly depreciation by the number of months each amount would have been included in plant in service through the end of the test period based on the numbers reported by Bluegrass Water.

Account #	Depreciation Rate	Date Placed into Service							Total
		3/31/2020	4/30/2020	1/31/2021	4/30/2021	5/31/2021	6/30/2021	10/31/2021	
352.100	2.22%	\$ 598,797	\$ 1,052	\$ 183,500	\$ -	\$ -	\$ -	\$ 34,872	\$ 818,222
352.200	1.11%	-	-	-	28,414	54,790	74,677	141,102	298,982
372.000	2.35%	-	-	-	-	-	278	-	278
Annual Depreciation Expense		13,293	23	4,074	315	608	835	2,340	21,490
Divided by: 12 Months		12	12	12	12	12	12	12	12
Monthly Depreciation Expense		1,108	2	339	26	51	70	195	1,791
Multiplied by: Depreciated Months		28	27	18	15	14	13	9	
Accumulated Depreciation		\$ 31,018	\$ 53	\$ 6,111	\$ 394	\$ 710	\$ 905	\$ 1,755	\$ 40,945

results in a reduction in depreciation expense in the amount of \$21,490, as indicated in the following table, for a total revenue requirement adjustment of \$158.847.

System	McBrayer		Total	Acct # 352.100	Acct # 352.200	Acct # 372.000	Total
	McGinnis Leslie & Kirkland PLL	The Beckemeier Law Firm, LC					
KY-Airview	\$ 55,583	\$ 32,863	\$ 88,446	\$ 88,446	\$ -	\$ -	\$ 88,446
KY-Arcadia Pines	25,598	26,871	52,469	14,050	38,419	-	52,469
KY-Brocklyn	26,707	27,771	54,478	54,478	-	-	54,478
KY-Carriage Park	24,642	22,409	47,050	10,792	36,258	-	47,050
KY-Delaplain Disposal	33,393	20,398	53,791	-	53,791	-	53,791
KY-Fox Run	27,656	33,851	61,507	61,229	-	278	61,507
KY-Golden Acres	34,545	28,961	63,505	63,505	-	-	63,505
KY-Great Oaks	30,717	28,961	59,678	59,678	-	-	59,678
KY-Herrington Haven	24,178	16,255	40,433	-	40,433	-	40,433
KY-Kingswood	35,333	22,923	58,255	58,255	-	-	58,255
KY-Lake Columbia	27,754	28,064	55,818	55,818	-	-	55,818
KY-LH Treatment	31,742	40,281	72,022	72,022	-	-	72,022
KY-Marshall Ridge	19,321	19,307	38,628	10,214	28,414	-	38,628
KY-Persimmon Ridge	41,629	63,989	105,618	105,618	-	-	105,618
KY-Randview	37,504	30,864	68,367	13,577	54,790	-	68,367
KY-River Bluffs	42,058	24,326	66,383	66,383	-	-	66,383
KY-Springcrest	21,468	13,404	34,872	34,872	-	-	34,872
KY-Timberland	30,743	18,541	49,284	49,284	-	-	49,284
KY-Woodland Acres	26,964	19,915	46,878	-	46,878	-	46,878
Total	\$ 597,532	\$ 519,950	\$ 1,117,482	818,222	298,982	278	1,117,482
Annual Depreciation Rate				2.22%	1.11%	2.35%	
Depreciation Expense for Legal Acquisition Expenses				\$ 18,165	\$ 3,319	\$ 7	\$ 21,490

Notably, the depreciation expense was calculated by applying Bluegrass Water's proposed depreciation rates for the accounts into which Bluegrass Water recorded the attorney fees to the attorney fees recorded in each such account.

#### Removal/Addition of Remote Monitoring Equipment

In Case No. 2022-00216, Bluegrass Water requested a CPCN to replace Mission remote monitoring equipment with High Tide remote monitoring equipment, because among other things, Bluegrass Water determined that the Mission equipment was not effective. During the course of that case, it was determined that Bluegrass Water had installed the High Tide equipment before obtaining a CPCN. Thus, the Commission denied the CPCN for the remote monitoring equipment that had already been install and

indicated that it would address Bluegrass Water's recovery of the costs of the High Tide equipment in its next rate case.

In this case, Bluegrass Water proposed to remove \$149,322 from rate base to account for the removal of Mission monitoring equipment,<sup>95</sup> which is the sum of the plant in service for Mission monitoring equipment of \$165,266 and accumulated depreciation for the Mission monitoring equipment of \$15,944.<sup>96</sup> Bluegrass Water proposed a corresponding adjustment to add \$118,424 to rate base to account for the installation of High Tide monitoring equipment,<sup>97</sup> which is the sum of the plant in service for High Tide monitoring equipment of \$123,363 and accumulated depreciation for High Tide monitoring equipment of \$4,939. However, Bluegrass Water did not reflect the revenue requirement effects of those changes in its proposed rates, because the CPCN case was pending when Bluegrass Water filed its application in this matter.

While Bluegrass Water failed to obtain a CPCN for the High Tide monitoring equipment, Bluegrass Water presented evidence in this case and in Case No. 2022-00216 that the equipment is needed and will not result in wasteful duplication. Specifically, the monitoring equipment allowed Bluegrass Water to reduce operator visits to each system, which resulted operation and maintenance costs as discussed below. Thus, despite failing to obtain a CPCN for the High Tide monitoring equipment, the

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<sup>95</sup> Bluegrass Water's Response to Staff's Post Hearing Requests, Item 6b, Exhibit\_PSC\_PH-6(b)-\_Schedule.xlsx, Cell E10.

<sup>96</sup> See Bluegrass Water's Response to Attorney General's Post Hearing Requests for Information (Attorney General's Post Hearing Requests) (filed Oct. 6, 2023), Item 4, Exhibit\_OAG\_PH-4-\_Remote\_Monitoring.xlsx, Tab Mission.

<sup>97</sup> Bluegrass Water's Response to Staff's Post Hearing Request, Item 6b, Exhibit\_PSC\_PH-6(b)-\_Schedule.xlsx, cell E11; see also Bluegrass Water's Response to Attorney General's Post Hearing Requests, Item 4, Exhibit\_OAG\_PH-4-\_Remote\_Monitoring.xlsx, Tab High Tide.

Commission finds that Bluegrass Water should be permitted include its investment in those systems in rate base, and therefore, finds that \$149,322 should be removed from rate base to account for the removal of Mission monitoring equipment and that \$118,424 should be added to rate base to account for the installation of High Tide monitoring equipment, which results in a net decrease of \$30,898<sup>98</sup> to rate base and a net decrease in plant in service in the amount of \$41,903.<sup>99</sup>

Based on the depreciation rate of 13.18 percent that Bluegrass Water applied to monitoring equipment,<sup>100</sup> the \$41,903 decrease in plant in service results in a \$5,523 decrease in depreciation expense.<sup>101</sup> The net adjustments to rate base associated with the removal of the Mission monitoring equipment and the addition of the High Tide monitoring equipment results in a decrease in the annual return in the amount of \$3,787 as shown in the table below.

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<sup>98</sup> \$118,424 - \$149,322 = \$30,898.

<sup>99</sup> \$123,363 - \$165,266 = \$41,903.

<sup>100</sup> Application, Exhibit 14, Application,\_Exhibit\_14\_-\_Direct\_Testimony\_of\_John\_J.\_Spanos.pdf, Exhibit JJS-1, Depreciation Study, at VI-4, Account # 393.000 Stores Equipment.

<sup>101</sup>

Net change if Plant-in-Service	\$	(41,903)
Depreciation rate		<u>13.18%</u>
Change to Depreciation Expense	\$	<u><u>(5,523)</u></u>

	<u>Removal of Mission Monitoring Equipment</u>	<u>Addition of High Tide Monitoring Equipment</u>
Rate Base Change	\$ (149,322)	\$ 118,424
Requested Return	<u>9.77%</u>	<u>9.77%</u>
Change in Return	(14,583)	11,566
Weighted Return on Equity	<u>7.13%</u>	<u>7.13%</u>
Net Income from ROE based on Original ROE and Capital Structure	(10,639)	8,438
Gross Revenue Conversion Factor	1.0101	1.0101
Gross Income Conversion Factor	<u>1.3459</u>	<u>1.3459</u>
Change in Return with Gross up	<u>\$ (18,303)</u>	<u>14,516</u>
Net Change in Return		<u>\$ (3,787)</u>

### Reduction of Rate Base due to Randview System Transfer

Bluegrass Water filed an application requesting approval to transfer the assets of the Randview system to Mayfield, which was approved during the pendency of this case.<sup>102</sup> Bluegrass Water determined that the revenue requirement impact of removing the Randview system was to reduce the overall revenue requirement by \$59,431.<sup>103</sup> In a break out of its calculation of the revenue requirement impact, Bluegrass Water reflected a difference of \$59,208 arising from the sale of Randview.<sup>104</sup>

Bluegrass Water's calculation of the change in the revenue requirement arising from the sale of Randview was based, in part, on a reduction in rate base in the amount

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<sup>102</sup> Case No. 2022-00218, *Electronic Joint Application of Bluegrass Water Utility Operating Company, LLC and the Electric Plant Board Of Mayfield, Kentucky for Approval of Acquisition and Transfer of Ownership And Control Of Wastewater Facilities Serving Randview Estates Subdivision in Graves County, Kentucky*, (Ky. PSC, May. 5, 2023).

<sup>103</sup> Application, Application\_Exhibit\_10\_-\_Direct\_Testimony\_of\_Brent\_Thies.pdf, at 26.

<sup>104</sup> See Bluegrass Water's Response to Attorney General's First Request for Information (Attorney General's First Request) (filed May 16, 2023), Item 56, Exhibit\_OAG\_1-56\_(Part\_1\_of\_3)\_Randview\_Adjustment.xlsx (\$6,388,068 - \$6,288,068 = \$100,000).

of \$100,000,<sup>105</sup> which appeared to be based on the price it received for Randview. In its original calculation of the revenue requirement, Bluegrass Water included net plant in service of \$119,017, consisting of \$124,374 in plant in service and \$5,356 in accumulated depreciation.<sup>106</sup> However, the \$124,374 plant in service amount included \$68,367 in attorney fees that Bluegrass Water had characterized as acquisition related costs that were removed as part of the adjustment discussed above. Similarly, the adjustment above removed \$1,161 in accumulated depreciation from Randview associated with attorney fees that Bluegrass Water had characterized as acquisition related costs. Excluding those plant in service and accumulated depreciation amounts, Bluegrass Water's net plant in service for Randview would be about \$51,812, based on \$56,007 in plant in service<sup>107</sup> and \$4,195 in accumulated depreciation.<sup>108</sup> Thus, given the adjustment made above to remove attorney fees that had been capitalized, Bluegrass Water's rate base should be reduced by only \$51,812 to reflect the sale of the Randview system and the removal of other costs as part of the adjustment above.

The adjustment to rate base associated with the sale of the Randview system results in a decrease in the annual return in the amount of \$6,351 as shown in the table below.

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<sup>105</sup> See Bluegrass Water's Response to Attorney General's First Request, Item 56, Exhibit\_OAG\_1-56\_(Part\_1\_of\_3)\_Randview\_Adjustment.xlsx (\$3,727,085 - \$3,667,877 = \$59,208).

<sup>106</sup> See Bluegrass Water's Response to Attorney General's First Request, Item 56, Exhibit\_OAG\_1-56\_(Part\_2\_of\_3)\_Randview\_Plant\_in\_Service\_Accum\_Depre.xlsx

<sup>107</sup> \$124,374 - \$68,367 = \$56,007.

<sup>108</sup> \$5,356 - \$1,161 = \$4,195.

	<u>Removal of Randview System</u>
Rate Base Change	(51,812)
Requested Return	<u>9.77%</u>
Change in Return	(5,060)
Weighted Return on Equity	<u>7.13%</u>
Net Income from ROE based on Original ROE and Capital Structure	(3,692)
Gross Revenue Conversion Factor	1.0101
Gross Income Conversion Factor	<u>1.3459</u>
Change in Return with Gross up	<u>\$ (6,351)</u>

Further, Bluegrass Water included \$3,350 in depreciation expense for Randview in the operating expense used to calculate the revenue requirement. However, the Commission removed \$909 in annual depreciation expense associated with the attorney fees for Randview that Bluegrass Water included in plant in service such that the sale of Randview and the removal of the plant in service associated with it will only result in the further reduction of depreciation expense in the amount of \$2,441.<sup>109</sup> Thus, the

<sup>109</sup> As shown in the following table, the Commission used the same method discussed above to estimate the depreciation expense and accumulated depreciation for Randview.

<u>Account #</u>	<u>Depreciation Rate</u>	<u>Date Placed into Service</u>		<u>Randview Total</u>
		<u>1/31/2021</u>	<u>5/31/2021</u>	
352.100	2.22%	\$ 13,557	\$ -	\$ 13,557
352.200	1.11%	-	54,790	54,790
372.000	2.35%	-	-	-
Annual Depreciation Expense		301	608	909
Divided by: 12 Months		<u>12</u>	<u>12</u>	<u>12</u>
Monthly Depreciation Expense		25	51	
Multiplied by: Depreciated Months		<u>18</u>	<u>14</u>	
Accumulated Depreciation		<u>\$ 451</u>	<u>\$ 710</u>	<u>\$ 1,161</u>

Commission finds that the revenue requirement should be reduced by \$8,810 to reflect the sale of the Randview system (in addition to the reductions in revenue and operation and maintenance expense discussed below).

### Pro Forma Plant Additions

Bluegrass Water made a pro forma adjustment of \$760,942 to its test year net plant in service.<sup>110</sup> The bulk of that adjustment was due to \$756,800 in projects at Woodland Acres, Persimmon Ridge, and Herrington Haven that Bluegrass Water projected would be completed and placed in service on or about June 30, 2024.<sup>111</sup> Specifically, Bluegrass Water's pro forma adjustment to include the \$756,800 in projects for Woodland Acres, Persimmon Ridge, and Herrington Haven resulted in an adjustment to net plant in service in the amount of \$750,942 arising from a net increase to plant in service in the amount of \$564,145 (the addition of the projects less any retirements) and a net decrease to accumulated depreciation in the amount of \$186,797 associated with the retirements.<sup>112</sup> Bluegrass Water argued that the adjustment to net plant in service associated with the projects at Woodland Acres, Persimmon Ridge, and Herrington Haven are "known and measurable" because they are related to "projects approved by

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<sup>110</sup> Exhibit BT-14.

<sup>111</sup> See Bluegrass Water's Response to Commission Staff's Second Request for Information (Staff's Second Request) (filed May 12, 2023), Item 17, Exhibit PSC 2-17 – KY Exhibits Submission – CONFIDENTIAL.xlsx, Schedule BT-4, Schedule BT-5, Exhibit 20 (show the calculation of the pro forma adjustment to plant in service and accumulated depreciation and the projects and in service dates that resulted in the bulk of the adjustments).

<sup>112</sup> See *Bluegrass Water's Response to Staff's Second Request*, Item 17, Exhibit PSC 2-17 – KY Exhibits Submission – CONFIDENTIAL.xlsx, Schedule BT-14 (indicating that the total pro forma adjustments to accumulated depreciation resulted in a net change in rate base of \$760,942); *Bluegrass Water's Response to Staff's Third Request*, Item 14 (indicating that \$10,000 of pro forma plant in service increase was not related to the plant additions at issue); *Bluegrass Water's Response to Staff's Third Request*, Item 17 (indicating a difference between the accumulated depreciation and the value of the assets being retired that affected that resulted in a difference between the cost of the plant additions and the change in net plant in service and rate base).

the Commission and that Bluegrass Water is working diligently to complete pursuant to the issued CPCNs.”<sup>113</sup>

Pursuant to KRS 278.192, a utility proposing a general increase in rates may justify the reasonableness of its proposed rates using a historical test period of 12 consecutive months or a forward-looking test period corresponding to the first 12 consecutive calendar months “the proposed increase would be in effect after the maximum suspension provided in KRS 278.190(2).” Section 16 of 807 KAR 5:001 establishes the filing requirements for applications for general rate adjustments and similarly requires that each application be supported by “[a] twelve (12) month historical test period that may include adjustments for known and measurable changes” or “[a] fully forecasted test period.”<sup>114</sup> Pursuant to 807 KAR 5:001, Section 16(5), “[u]pon good cause shown, a utility may request pro forma adjustments for known and measurable changes to ensure fair, just and reasonable rates based on the historical test period.”

Bluegrass Water failed to establish that a known and measurable adjustment is justified to reflect changes to Bluegrass Water’s net plant in service associated with the Woodland Acres, Persimmon Ridge, and Herrington Haven projects. The grant of a CPCN does not require or guarantee that a project will be completed, so the fact that the Commission granted a CPCN for a project alone would not establish that the project should be included as a known and measurable change to ensure fair, just and reasonable rates. Further, both the final costs and timing of the projects are estimates. For instance, when Bluegrass Water was asked in July 2023, nearly a year after the end

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<sup>113</sup> Bluegrass Water’s Brief at 35.

<sup>114</sup> 807 KAR 5:001, Section 16 (1)(a).

of the test period, to provide the estimated in-service dates for each project and to explain how each such in-service date was projected, Bluegrass Water stated that the estimated in-service date for all the projects is June 2024 and that:

Without having confirmation from contractors at the time of filing, this date was a reasonable estimate because Bluegrass believed the work could be completed by June 2024.<sup>115</sup>

Finally, allowing Bluegrass Water to include the full estimated costs of projects in rate base before they are completed would result in Bluegrass Water recovering costs it has not yet incurred, which would be unreasonable, and would allow recovery of costs it could not have recovered if Bluegrass Water had filed a forecasted test year, which would be illogical given that the primary purpose of a forecasted test period is to reduce recovery lag as compared to the use of a historical test period. Further, it would be unreasonable to include forecasted plant additions as Bluegrass Water proposed while failing to account for other rate base changes such as the continue accumulation of depreciation following the forecasted test year. Thus, the Commission finds that Bluegrass Water failed to establish that the adjustments to net plant in service associated with the Woodland Acres, Persimmon Ridge, and Herrington Haven projects should be reflected as known and measurable changes to ensure fair, just and reasonable rates, and therefore, finds that those adjustments should be removed.

The adjustment to rate base associated with the removal of the pro forma adjustment results in a net change in rate base in the amount of \$750,942 based on the schedules filed by Bluegrass Water. That reduction in rate base results in a decrease in

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<sup>115</sup> Bluegrass Water's Response to Commission Staff's Fourth Request for Information (Staff's Fourth Request) (filed Aug. 2, 2023), Item 22.

the annual return in the amount of \$92,047 as shown in the table below using the return and method used by Bluegrass Water in its schedules. The removal of the pro forma adjustment does not result in a change in depreciation expense, because Bluegrass Water's pro forma adjustment to depreciation expense did not include expenses related to this adjustment.

	<u>Removal of Pro Forma Additions</u>
Rate Base Change Requested Return	\$ (750,942) <u>9.77%</u>
Change in Return Weighted Return on Equity	(73,339) <u>7.13%</u>
Net Income from ROE based on Original ROE and Capital Structure	(53,506)
Gross Revenue Conversion Factor	1.0101
Gross Income Conversion Factor	<u>1.3459</u>
Change in Return with Gross up	<u>\$ (92,047)</u>

Change in Rate Base due to Removal of Rate Case Expense.

Bluegrass Water requested that its estimated deferred rate case expenses of \$179,558 from the instant filing be included in rate base<sup>116</sup> and that a three year amortization period be utilized for ratemaking purposes.<sup>117</sup>

The Commission disagrees that rate case expense regulatory assets should be included in rate base, as that would allow a return on the unamortized balance of the

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<sup>116</sup> Application, Direct Testimony of Brent Thies on Behalf of Bluegrass Water Utility Operating Company, LLC (Thies Direct Testimony), Exhibit BT-14.

<sup>117</sup> Application, Exhibit 10, Application\_Exhibit\_10\_-\_Direct\_Testimony\_of\_Brent\_Thies.pdf, at 19.

expense. The Commission has historically excluded this item from rate base to share the cost of rate proceedings between the stockholders and ratepayers.<sup>118</sup> The total revenue requirement reduction, before any gross up, is about \$17,536.<sup>119</sup>

Cash Working Capital Allowance

Bluegrass Water calculated its cash working capital allowance of \$225,898 by using the 45-day or 1/8th convention,<sup>120</sup> after adjusting for the impacts of Bluegrass Water’s proposed adjustments to O&M expenses. Many jurisdictions use a 45-day convention to produce a reasonable working capital adjustment without the need to conduct an expensive lead/lag study.<sup>121</sup> The Commission finds the 1/8th approach to be a reasonable approach for Bluegrass Water, particularly given its size and relative sophistication. Therefore, the Commission permits the use of the 1/8th convention in this Order and approves a cash working capital allowance of \$191,325 to reflect the pro forma O&M expenses the Commission Calculated.

<u>Description</u>	<u>Commission Determined Operating Expense</u>	<u>Lead Days</u>	<u>Working Capital Requirement</u>
Operating Expenses for Test Period	\$ 1,551,861	45	\$ 191,325
Total Working Capital	<u>\$ 1,551,861</u>	<u>45</u>	<u>\$ 191,325</u>

<sup>118</sup> Case No. 2004-00103, *Adjustment of the Rates of Kentucky-American Water Company* (Ky. PSC Feb. 28, 2005), Order at 35.

<sup>119</sup> Rate Case Expense \$179,558 multiplied by Requested Rate of Return 9.8 percent = \$17,536.

<sup>120</sup> Application, Exhibit 10, Application\_Exhibit\_10\_-\_Direct\_Testimony\_of\_Brent\_Thies.pdf, at 24.

<sup>121</sup> Application, Exhibit 10, Application\_Exhibit\_10\_-\_Direct\_Testimony\_of\_Brent\_Thies.pdf, at 24.

## Summary of Rate Base Adjustments

Based on the adjustments discussed above, the Commission has determined that Bluegrass Water's net investment rate base for its sewer division is \$4,199,357, as shown in the following table.

Bluegrass Water's Proposed - Commission Approved				
Line Number	Description	Pro Forma For the 12 Months Ended June 30, 2022	Commission Approved Adjustments	Pro Forma For the 12 Months Ended June 30, 2022
1				
2	Utility Plant in Service	\$ 8,930,263	\$ (564,145)	
			(165,266)	
			123,363	
			(1,117,482)	
			(56,007)	
			(698,456)	
			<u>(2,477,993)</u>	<u>6,452,271</u>
4	Accumulated Provision for Depreciation	(2,933,524)	186,797	
			15,944	
			(4,939)	
			40,945	
			4,195	
			<u>242,942</u>	<u>(2,690,581)</u>
5	Accumulated Amortization	-	-	-
6				
7	Utility Plant Acquisition Adjustments	90,171		90,171
8				
9	Net Plant Acquisition Adjustments	6,086,911	(4,470,101)	3,851,860
10				
11	Less:			
12	Contributions in Aid of Construction, net	(104,299)	-	(104,299)
13				
14	Subtotal:	(104,299)	-	(104,299)
15				
16	Add:			
17	Cash Working Capital	225,898	225,898	451,796
18	Rate Case Expense	179,558	(179,558)	-
19				
20	Subtotal:	405,456	46,340	451,796
21				
22	Total Original Cost Rate Base	<u>\$ 6,388,068</u>	<u>\$ (4,423,761)</u>	<u>\$ 4,199,357</u>
23				

## OPERATING INCOME

### Late Payment Fees

As discussed in more detail in the rate design section, the Commission agrees that late fees are an important tool for a sewage utility to discourage untimely payments due to difficulties in terminating sewer service in the event of non-payment. However, as argued by the Attorney General, it is necessary to account for the revenue from such late fees, as with other non-recurring charges, and to reduce the revenue requirement necessary from base rates by those amounts. Failing to do so would be unreasonable, because it would result in customers paying for costs in base rates that are already being covered through the late fees and would result in a windfall to Bluegrass Water.

The Attorney General proposed to increase Pro-Forma Revenues by \$341,790<sup>122</sup> to reflect the revenues Bluegrass Water would receive from late fees in excess of the \$14,244 included in the test year.<sup>123</sup> While Bluegrass Water indicated that the calculation relied on by the Attorney General was accurate based on the manner in which Bluegrass Water proposed to apply late fees,<sup>124</sup> which would apparently include applying the late fee to the same amounts if late on a subsequent bill, the Commission is modifying the manner in which Bluegrass Water's late fee will apply as discussed below in the rate design section such that it will only apply to the first time an amount owed is late consistent with the Commission's regulation. Further, the proposed revenue from late fees is

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<sup>122</sup> Dittmore Direct Testimony, DND-6

<sup>123</sup> Bluegrass Water's Proposed Late Fee Revenues \$352,865 – Less Actual Late Fees Collected \$14,244 = proposed increase to pro-forma revenues \$341,790.

<sup>124</sup> Thies Rebuttal Testimony at 5-7.

approximately 14.44 percent of Bluegrass Water's pro forma revenues.<sup>125</sup> Based on a 10 percent late fee, the proposed amount presumes that all of Bluegrass Water customers pay late each month of the revenue cycle, which seems highly unlikely. Thus, the Commission does not believe that the full adjustment proposed by Attorney General accurately reflects Bluegrass Water's expected revenue from late fees,<sup>126</sup> and there is not information in the record to accurately estimate the expected revenue from the late fees.

To address this issue, the Commission could simply eliminate Bluegrass Water's late fees, but the Commission does believe that the late fees are important for Bluegrass Water to ensure timely payment and limit costs associated with late payments that could ultimately be paid by other customers. The Commission is also concerned about including such substantial other revenues that are apparently inaccurate and the affect it could have on Bluegrass Water's financial condition and costs to customers. Thus, the Commission will not make the Attorney General's proposed adjustment to revenues for late fees.

To prevent the unreasonable rates that would arise if Bluegrass Water failed to account for late fee revenues, the Commission finds that Bluegrass Water should track all invoiced late fees and record them as a regulatory asset or liability to the extent that they exceed the \$14,244 in late fee revenue Bluegrass Water included in the test period. The Commission further finds that within 60 days after the 12-month period following the effective date of the rates in this case, Bluegrass Water shall report to the Commission the monthly amount of late fees invoiced, the monthly number of occurrences of late fees,

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<sup>125</sup> \$341,790 divided by Pro Forma Revenues \$2,367,583 = 14.44%.

<sup>126</sup> The calculation appears to assume that the late fee will apply to all delinquent amounts in a manner that is contrary to Commission regulations.

and the monthly total number of Bluegrass Water customers for the 12-month period. Further, Bluegrass Water shall propose a method for timely distribution of the accumulated amount to its customers. This process shall continue on a 12-month basis until a subsequent base rate order is issued.

#### Removal of Revenues and Expenses due to the Sale of Randview System

Bluegrass Water reported Randview generated \$52,664 in revenues for the test year, while also costing \$41,002 in total operations and maintenance expenses.<sup>127</sup> Since Bluegrass Water is no longer operating the Randview system, these revenues and expenses need to be removed from the test year amounts. Therefore, the Commission reduced Revenues by \$52,664 and reduced Sewer-Contract Operations Labor & Expenses by \$41,002.

#### Depreciation Rates

Bluegrass Water engaged John Spanos of Gannett Fleming Valuation and Rate Consultants, LLC to complete a depreciation study on its assets (Depreciation Study). Bluegrass Water proposed to use the rates proposed by Mr. Spanos to depreciate assets on the books as of June 30, 2022. The result of the Depreciation Study proposed a test year depreciation expense of \$193,680.<sup>128</sup> Bluegrass Water reported a test year depreciation expense of \$187,171.<sup>129</sup> Thus, Bluegrass Water proposed a pro forma

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<sup>127</sup> Bluegrass Water's Response to Attorney General's First Request, Item 56, Exhibit\_OAG\_1-56\_(Part\_3\_of\_3)\_Randview.xlsx.

<sup>128</sup> Application, Exhibit 14, Application\_Exhibit\_14\_-\_Direct\_Testimony\_of\_John\_J.\_Spanos.pdf, Exhibit 1, Depreciation Study, at VI-3.

<sup>129</sup> Application, Exhibit 25.

increase to its test year depreciation expense in the amount of \$8,583<sup>130</sup> to reflect the results of the Depreciation Study.<sup>131</sup>

Except for the net salvage values discussed separately below, the Commission finds that Bluegrass Water's proposed depreciation rates are reasonable. However, the difference between the depreciation expense calculated pursuant to the depreciation rates and the depreciation expense calculated at previous rates was \$6,509 as opposed to \$8,583. Thus, the Commission finds that Bluegrass Water's pro forma depreciation expense should be decreased by \$2,074.

#### Depreciation Expense – Negative Net Salvage Value.

Bluegrass Water included a negative net salvage value in its depreciation rates, which had the effect of increasing the depreciation rate. The negative net salvage value varies for each capital asset category ranging from zero to 30 percent.<sup>132</sup> However, Bluegrass Water acknowledged that net salvage value is an expense incurred when an asset is retired and replaced, with some of the incurred cost being assigned to the new asset and some to the old.<sup>133</sup> Bluegrass Water's witness Spanos testified that the most appropriate way to record the cost is to include the cost of retirement into the cost of a new asset and depreciate it over the useful life.<sup>134</sup>

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<sup>130</sup> Bluegrass Water's Response to Attorney General's Second Request, Item 20(d), Exhibit\_OAG\_2-20(d)\_Depreciation\_Study\_Adjustment.xlsx, Column E.

<sup>131</sup> Bluegrass Water's Response to Attorney Generals First Request, Item 113, Exhibit\_OAG\_1-113\_-\_Known\_Measurable\_Adjustment\_Explinations\_(1).xlsx, Interest & Depr Cal tab, Cell F10.

<sup>132</sup> Application, Exhibit 14, Application\_Exhibit\_14\_-\_Direct\_Testimony\_of\_John\_J\_Spanos.pdf, Exhibit JJS-1, at 83.

<sup>133</sup> HVT of the Sept. 19, 2023 Hearing, John J. Spanos Testimony, 57:35.

<sup>134</sup> HVT of the Sept. 19, 2023 Hearing, John J. Spanos Testimony, 58:38.

Bluegrass Water acknowledged that “going forward” the expectation is that new projects will include decommissioning costs of the old asset as well as the costs for the installation of new assets the cost.<sup>135</sup> Bluegrass Water determined the old systems it purchased were not collecting the removal costs of its assets,<sup>136</sup> based upon some assets having a zero net salvage value and due to the size of the facility not requiring them to keep the records in the same manner showing a lack of costs included into accumulated depreciation.<sup>137</sup> Bluegrass Water determined that the “original” cost established for purchased assets did not include any cost to remove the asset.<sup>138</sup>

The Commission finds that large projects to replace significant plant assets likely also have decommissioning costs baked into the estimates (a utility must “replace” existing plant by removing what is currently there),<sup>139</sup> so Bluegrass Water is seeking to have its customers pay for at least some decommissioning costs of existing plant while also recovering a separate negative net salvage value. Given that the negative net salvage value is not supported by evidence, there is no way to determine if its inclusion under the net circumstances will result in duplicative cost recovery or if it is otherwise reasonable. Thus, the Commission finds that Bluegrass Water failed to establish that a negative net salvage value is appropriate in this case.

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<sup>135</sup> HVT of the Sept. 19, 2023 Hearing, John J. Spanos Testimony, 59:38

<sup>136</sup> HVT of the Sept. 19, 2023 Hearing, John J. Spanos Testimony, 1:00:35

<sup>137</sup> HVT of the Sept. 19, 2023 Hearing, John J. Spanos Testimony, 1:01:55

<sup>138</sup> HVT of the Sept. 19, 2023 Hearing, John J. Spanos Testimony, 1:16:40.

<sup>139</sup> See Bluegrass Water response to Staff’s Fourth Request, Item 4 (referring to evidence and the record in Case No. 2020-00290 to support the costs and need for the projects); Bluegrass Water’s response to Staff’s Fourth Request, Item 5, Exhibit PSC 4-5(b)(Parts 1-5) (providing engineering reports with cost estimates for work to repair the systems with little to no break out of the cost of removal); *see also* Case No. 2020-00290, Aug. 2, 2021 Order at 65-66 (discussing how Bluegrass Water acknowledged that the costs of two new projects included the embedded cost to decommission the old projects).

The adjustments to the depreciation expense to remove the attorney fees from the acquisition related costs results in a decrease to the book value for the plant in service accounts by a net of \$1,117,482.<sup>140</sup> Additionally, the sale of the Randview system reduces the plant in service accounts by a net of \$124,372.<sup>141</sup> Both of the adjustments alter the Book Value for assets classes that have a negative net Salvage percent, and since all depreciation associated with those assets, including negative net salvage value, was removed above, it is necessary to account for the removal of the negative net salvage value associated with those assets removed above when calculating the removal of negative net salvage value here to ensure the same expense is not removed twice. The adjustments to remove the Mission Monitoring equipment and install the High Tide monitoring system involve depreciation accounts that do not have negative net salvage values, therefore do not affect the adjustment for negative net salvage value. Therefore, the Commission reduced the depreciation expense adjustment by \$26,222, by removing the negative net salvage value from the original costs for asset, excluding the salvage value for plant associated with the attorney fees and Randview, as shown in the following table.

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<sup>140</sup> Account #352.100 \$804,645 + Account #352.200 \$244,192 + Account #372.000 \$278 = \$1,049,115.

<sup>141</sup> Account #311.000 \$11,098 + Account #352.100 \$19,598 + Account #352.200 \$89,400 + Account #353.000 \$416 + Account #370.000 \$2,831 + Account #370.100 \$165 + Account #372.000 \$864 = \$124,372

NARUC	Depreciable Group	Survivor Curve	Net salvage percent	Total Original cost	Original Net Salvage Value	Book Depreciation Reserve	Future Book Accruals	Depreciation Expense including Net Salvage Value	Depreciation Expense not including Net Salvage Value	Difference
303.00	Miscellaneous Intangible Plant	50	0%	\$ 20,323	\$ -	\$ -	\$ 20,323	\$ 1,016	\$ 1,016	\$ -
311.00	Structures and improvements	50	-10%	734,112	(73,411.19)	89,767	717,756	42,471.00	38,127	(4,344)
352.10	Collection Sewers - Force	55	-5%	718,277	(35,913.83)	73,467	680,723	15,094.00	14,297	(797)
352.20	Collection Sewers - Gravity	55	-5%	1,660,660	(83,032.98)	1,208,163	535,530	13,322.00	11,256	(2,066)
353.00	Services	50	-10%	706,871	(70,687.08)	481,021	296,537	23,167.00	17,645	(5,522)
355.00	Power Generating Equipment	35	0%	5,915	-	1,911	4,004	636.00	636	-
363.00	Electric Pumping Equipment	30	-5%	81,256	(4,063)	35,829	49,490	3,299.00	3,028	(271)
370.10	Oxidation Lagoons	40	-30%	38,589	(11,576.62)	24,500	25,665	3,889.00	2,135	(1,754)
372.00	Treatment and Disposal Equipment	30	-10%	1,684,393	(168,439.28)	1,019,363	833,469	39,501.00	31,518	(7,983)
373.00	Plant Sewers	40	-10%	205,734	(20,573)	173,840	52,467	3,721.00	2,262	(1,459)
374.00	Outfall Sewer Lines	50	-10%	22,240	(2,224)	12,634	11,830	1,286.00	1,044	(242)
375.00	Other Treatment and Disposal	25	-10%	69,562	(6,956)	55,766	20,752	5,321.00	3,537	(1,784)
376.00	Other Equipment	30	0%	959	-	906	53	53.00	53	-
391.00	Office Furniture and Equipment	20	0%	2,440	-	2,440	-	-	-	-
393.00	Stores Equipment	25	0%	90,799	-	36,510	54,288	12,064.00	12,064	-
397.00	Communication Equipment	15	0%	5,000	-	5,000	-	-	-	-
Total				\$ 6,047,129	\$ (476,877)	\$ 3,221,117	\$ 3,302,889	\$ 164,840	\$ 138,618	\$ (26,222)

### Mission Operating Income Savings

The total Operating Income Adjustment related to the transition from Mission remote monitoring equipment is \$30,737, which was incorrectly set forth as \$16,370 due to a formula error in the Excel sheet filed as Bluegrass Water's Exhibit PSC PH-6(b).<sup>142</sup> The operating income adjustment of \$30,737 is comprised of the total annual Mission subscription cost that will no longer be incurred and the annual depreciation expense of the Mission units that will no longer be incurred. The total annual subscription savings is \$19,719.<sup>143</sup>

The Commission agrees with Bluegrass Water's methodology, however the Commission determined Bluegrass Water made a mathematical error in its calculation of \$19,719. The Commission calculated a total annual mission subscription cost savings of \$19,705, as shown in the following table. Since the Mission Monitoring equipment is being removed, no further subscription costs will be incurred, and therefore it needs to be removed from the Revenue Requirement.

<sup>142</sup> Bluegrass Water's Response to Staff's Post Hearing Requests, Item 6, Exhibit PSC PH-6(b).

<sup>143</sup> Bluegrass Water's Post Hearing Brief at 44.

Annual Mission Subscription Cost	\$563 <sup>144</sup>
Multiplied by: Number of Mission Units	<u>35<sup>145</sup></u>
Total Annual Mission Subscription Cost	<u>\$19,705</u>

Operating Expenses for High Tide Monitoring System.

In addition to the reduction for the discontinuation of Mission Remote monitoring, Bluegrass Water also agreed to remote monitoring from High Tide. Bluegrass Water reported that High Tide remote monitoring would cost \$23,728 annually.<sup>146</sup> Since Bluegrass Water transitioned away from Mission Monitoring and now utilizes High Tide Monitoring, the Commission agrees with adjusting Revenue Requirement by \$23,728.

Amortization of Rate Case Expense.

In the application, Bluegrass Water proposed an adjustment to increase Amortization Expense by \$59,853 to reflect the three-year amortization of the estimated rate case expense.<sup>147</sup> Bluegrass Water calculate a total rate case expense of \$179,558.<sup>148</sup> None of the Intervenors objected to Bluegrass Waters proposed rate case expense. The Commission finds Bluegrass Waters proposed adjustment is reasonable, and that all expenses related to the preparation of the rate case need to be accounted for

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<sup>144</sup> Bluegrass Water's Response to Attorney General's Post Hearing Request, Item 4, Exhibit\_OAG\_PH-4\_-\_Remote\_Monitoring.xlsx, Operations Cost Tab, Cell F6.

<sup>145</sup> Bluegrass Water's Response to Attorney General's Post Hearing Request, Item 4, Exhibit\_OAG\_PH-4\_-\_Remote\_Monitoring.xlsx, Mission Tab, rows 5 – 40.

<sup>146</sup> Bluegrass Water's Response to Staff's Post Hearing Requests, Item 6b, Exhibit\_PSC\_PH-6(b)\_-\_Schedule.xlsx, cell E23.

<sup>147</sup> Application, Exhibit 10, Application\_Exhibit\_10\_-\_Direct\_Testimony\_of\_Brent\_Thies.pdf, BT-3.

<sup>148</sup> Application, Exhibit 10, Application\_Exhibit\_10\_-\_Direct\_Testimony\_of\_Brent\_Thies.pdf, BT-12.

including legal, accounting, consulting, and other expenses should be recoverable. Bluegrass Water’s Rate Case Amortization Expense should be increased by \$59,853, as shown below, in order to allow for the recovery of the cost of rate case assistance.

Item	Vendor	Total Expense
Depreciation Study	Gannett Fleming Rate Case Consultants	\$ 28,225
Class Cost of Service/Rate Design Study	ScottMadden, Inc.	5,300
Rate of Return Study	ScottMadden, Inc.	20,000
Legal Expenditures	Dinsmore & Shohl LLP	<u>126,033</u>
	Total Rate Case Expense	179,558
	Divide by: 3 year Ammortization Period	<u>3</u>
	Annual Rate Case Expense	<u>\$ 59,853</u>

Adjustments Related to Darlington Creek Mid-Year Acquisition.

During the test year, Bluegrass Water closed on the acquisition of Darlington Creek wastewater system.<sup>149</sup> In the application, Bluegrass Water proposed several adjustments to account for the annualization of Darlington Creek Sewer System. Darlington Creek was acquired on March 31, 2022, and Bluegrass Water was unable to record a full twelve months of Revenues and expenses for that system.<sup>150</sup> Therefore, Bluegrass Water provided the actual revenues and expenses related to Darlington Creek and annualized them as a known and measurable adjustment to the test period.<sup>151</sup>

The Commission reviewed Bluegrass Water’s proposed adjustment and determined the proposed adjustment is the Fiscal year total that is calculated by combining the Test year total and the annualized amount. The Commission disagrees

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<sup>149</sup> Case No. 2021-00265, *Electronic Proposed Acquisition of Wastewater System Facilities by Bluegrass Water Utility Operating Company, LLC*, (Ky. PSC. Feb.24, 2022),

<sup>150</sup> Application, Exhibit 10, Application\_Exhibit\_10\_-\_Direct\_Testimony\_of\_Brent\_Thies.pdf, at 10.

<sup>151</sup> Bluegrass Water’s Response to Attorney Generals First Request, Item 113, Exhibit\_OAG\_1-113\_-\_Known\_Measurable\_Adjsustment\_Explinations\_(1).xlsx.

with using the Fiscal year total as the adjustment and instead determined since the March, April, May, and June expenses should already be included in the test year ended June 30, 2022, amount the adjustment should be the calculated Annualized Amount.

Bad Debt Expense is calculated and determined in separate adjustment calculation; and is therefore not a part of the calculations. Therefore, as shown below, Bluegrass Water's proposed adjustments are reduced by the amount already incurred during the test year. Bluegrass Water's proposed Sewer Revenues adjustment is decreased by \$15,347 for a total adjustment of \$61,389. In addition the expense adjustments are reduced as well; Contractor Operations is reduced by \$18,028 for a total adjustment of \$88,168, Electric utilities reduced by \$1,079 for a total adjustment of \$3,237, Miscellaneous operations is reduced by \$27,118 for a total adjustment of \$81,355, Mowing and Ground Maintenance reduced by \$868 for a total adjustment of \$2,604, Taxes is reduced by \$120 for a total adjustment of \$360, Property Tax is reduced by \$35 for a total adjustment of \$104, Billing expense is reduced by \$792 for a total adjustment of \$2,375, Billing Expense – Bank Fees is reduced by \$146 for a total adjustment of \$437, OSS Bank Fees is reduced by \$6 for a total adjustment of \$18, OSS Legal expense is reduced by \$248 for a total adjustment of \$743, OSS Accounting is reduced by \$114 for a total adjustment of \$342, OSS Management Consulting is reduced by \$122 for a total adjustment of \$367, and the OSS-IT adjustment will be reduced by \$24 for a total adjustment of \$72 for the test year. All the adjustments net together for a reduction in Operating Revenues of \$61,389 and an increase in operating expenses of \$180,182, for a combined decrease to the operating income of \$118,792.

NARUC						Test Year	Annualization	Fiscal Year
Account	Category	3/31/2022	4/30/2022	5/31/2022	6/30/2022	Total	Amount	Total
521.000	Revenue-Sewer	\$ -	\$ 5,135	\$ 5,109	\$ 5,104	\$ 15,347	\$ 61,389	\$ 76,736
701.000	Sewer - Contract Operations	-	-	-	18,028	18,028	88,168	106,196
703.000	Sewer - Electric Utilities	-	234	397	448	1,079	3,237	4,316
705.000	Sewer - Misc Operations	285	11,920	8,879	6,033	27,118	81,355	108,473
711.000	Sewer - Mowing & Grounds Maintenance	-	868	-	-	868	2,604	3,472
408.100	Taxes	-	7	-	113	120	360	480
408.160	Property Tax	9	9	9	9	35	104	138
903.100	Billing Expense	13	56	311	411	792	2,375	3,167
903.280	Billing Expense- Bank Fees	3	70	35	37	146	437	582
923.100	OSS - Bank Fees	-	6	-	-	6	18	24
923.400	OSS - Legal	40	-	59	149	248	743	991
923.500	OSS - Accounting	17	32	32	32	114	342	456
923.600	OSS - Management Consulting	116	(84)	63	28	122	367	489
923.900	OSS - IT	-	-	24	-	24	72	96
	Operating Revenues	-	5,135	5,109	5,104	15,347	61,389	76,736
	Operating Expenses	483	13,118	9,810	25,288	48,699	180,182	228,881
	Operating Income	\$ (483)	\$ (7,983)	\$ (4,701)	\$ (20,184)	\$ (33,352)	\$ (118,792)	\$ (152,144)

### Property Tax Expense

In the application, Bluegrass Water proposed an adjustment to increase Property Tax Expense by a net of \$15,945.<sup>152</sup> The first component of the Property Tax adjustment is an increase of \$138<sup>153</sup> to account for the annualization of property taxes due to the mid-year acquisition of Darlington Creek, as previously addressed; the second part is an increase to property tax of \$15,807<sup>154</sup> to reflect the true-up of property taxes to the level actually paid during the test period. Bluegrass Water provided supporting documentation for the adjustment to true-up property tax expense to the actual amount paid during the test year.<sup>155</sup> The Commission agrees with Bluegrass Water's proposal to true-up the property taxes to the actual amounts paid during the test year.

<sup>152</sup> Application, Exhibit 10, Application\_Exhibit\_10\_-\_Direct\_Testimony\_of\_Brent\_Thies. BT-3. And Application, Exhibit 25.

<sup>153</sup> Bluegrass Water's Response to Attorney Generals First Request, Item 113, Exhibit\_OAG\_1-113\_-\_Known\_Measurable\_Adjustment\_Explinations\_(1).xlsx, Adjustments tab, cell G8.

<sup>154</sup> Bluegrass Water's Response to Attorney Generals First Request, Item 113, Exhibit\_OAG\_1-113\_-\_Known\_Measurable\_Adjustment\_Explinations\_(1).xlsx, Adjustments tab, cell G21.

<sup>155</sup> Bluegrass Water's Response to Attorney Generals First Request, Item 123, Exhibit\_OAG\_1-123\_-\_Property\_Tax\_Adjustment.xlsx.

Site Visit Waiver/ Dailey Inspection Requirement in Case No. 2022-00216.

In the application, Bluegrass Water testified that it had filed a CPCN application related to the installation of remote monitoring equipment at several plants as well as a site visit waiver.<sup>156</sup> Bluegrass Water had not included adjustments related to the remote monitoring equipment and the site waiver, however it would have an impact on Revenue Requirement.<sup>157</sup>

The requested project was proposed to increase Rate Base by \$230,101 as well as increase the Revenue Requirement by \$51,447. However since it was still a pending case, it was not incorporated into the calculations.<sup>158</sup> Attorney General Witness Dittmore testified he did not incorporate the Revenue Requirement implications of the proposals into his analysis.<sup>159</sup> On August 2, 2023, the Commission issued its order denying the CPCN for the remote monitoring equipment,<sup>160</sup> as the equipment has already been installed and is therefore not eligible for a CPCN.<sup>161</sup> The Commission did grant Bluegrass Water a waiver from daily inspection requirements.<sup>162</sup>

Witness Dittmore, agrees that Bluegrass Water will reduce its expenses by not performing daily in-person visits, but disagreed with Bluegrass Water's initial proposal of

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<sup>156</sup> Case No. 2022-00216, *Electronic Application of Bluegrass Water Utility Operating Company, LLC for a Certificate of Public Convenience and Necessity for the Installation of Monitoring Equipment and for a Corresponding Limited Waiver of Daily Inspection Requirements.*

<sup>157</sup> Application, Application\_Exhibit\_10\_-\_Direct\_Testimony\_of\_Brent\_Thies.pdf, at 26.

<sup>158</sup> Application, Application\_Exhibit\_10\_-\_Direct\_Testimony\_of\_Brent\_Thies.pdf, at 26.

<sup>159</sup> Testimony of David Dittmore, (filed Jun. 30, 2023), Dittmore\_Public\_Testimony\_Combined.pdf, at 14.

<sup>160</sup> Case No. 2022-00216, Aug. 2, 2023 Order at 9, ordering paragraph 1.

<sup>161</sup> Case No. 2022-00216, Aug. 2, 2023 Order at 7.

<sup>162</sup> Case No. 2022-00216, Aug. 2, 2023 Order at 7.

\$168,433. Witness Dittmore, proposed that the Revenue Requirement should be decreased by at least \$196,350.<sup>163</sup>

When accounting for the site visit waiver and the operational savings achieved from transitioning the remote monitoring services to High Tide from Mission, Bluegrass Water testifies it agrees with Witness Dittmore and will realize \$196,350 in operational savings per year.<sup>164</sup>

The Commission agrees with Bluegrass Water and the Attorney General that granting the in-person site visit waiver will result in savings to Bluegrass Water and reduces the revenue requirement by \$196,350.

#### Operator Contract Expense

In its application, Bluegrass Water included operating expenses attributed to system operator contracts incurred by Bluegrass Water's operational contractor, Midwest Water Operations (Midwest) (which was acquired by Clearwater Solutions following the expiration of the test year) of about \$1,000,000 for its sewer and water systems, respectively, in the historic test period.<sup>165</sup>

Bluegrass Water asserted Midwest best serves Bluegrass Water's customers because it is able to provide operational expertise, equipment, and tools at a price Bluegrass Water could not meet by hiring its own employees and purchasing the necessary equipment, tools, vehicles, and additional insurance expenses.<sup>166</sup> Mr. Cox

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<sup>163</sup> Attorney General's Post Hearing Brief at 9.

<sup>164</sup> Bluegrass Water's Post Hearing Brief at 14 – 15, item ii.

<sup>165</sup> Bluegrass Water's Post-Hearing Brief at 30.

<sup>166</sup> Bluegrass Water's Post-Hearing Brief at 31.

testified at the hearing that, to meet all compliance requirements, including OSHA requirements, a single employee cannot perform the operational tasks that are provided by Midwest.<sup>167</sup> As a result, Bluegrass Water claimed it could not employ the necessary individuals to perform all required maintenance, buy equipment, and buy necessary tools at a cost that is less than or even equal to the costs charged by Midwest.<sup>168</sup> Instead, Bluegrass Water stated that Midwest is able to more economically and efficiently provide the services due to its operations in over 13 states, including the operation of various municipal facilities across the Southeast United States.<sup>169</sup>

Bluegrass Water further stated it has undertaken efforts to employ its Request for Qualifications (RFQ) and Request for Proposals (RFP) process to attempt to find qualified contractors to assist with operations of the Bluegrass Water systems. However, Mr. Cox testified at the hearing that it has been very difficult to find and retain qualified operators in Kentucky.<sup>170</sup> Mr. Thomas explained that Bluegrass Water's awarding of contracts to service its systems has directly resulted in Midwest hiring Kentucky citizens to service Bluegrass Water's systems.<sup>171</sup> Despite these difficulties, Bluegrass Water claimed its RFQ and RFP processes and acquisitions of additional systems have allowed it to achieve cost savings created by economies of scale. Specifically, Mr. Cox testified that market pressures have been exerted on Midwest to keep the contract prices the same

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<sup>167</sup> HVT of the Sept. 19, 2023 Hearing, Josiah Cox Hearing Testimony, at 04:52.

<sup>168</sup> HVT of the Sept. 19, 2023 Hearing, Josiah Cox Hearing Testimony, at 04:54.

<sup>169</sup> Bluegrass Water's Post-Hearing Brief at 31.

<sup>170</sup> HVT of the Sept. 19, 2023 Hearing, Josiah Cox Hearing Testimony, at 04:35.

<sup>171</sup> See Direct Testimony of Todd Thomas, Application Exhibit 23, 13-17.

during a highly inflationary market.<sup>172</sup> Bluegrass Water stated that when the Midwest contract was extended for an additional year in 2023, the prices remained the same.<sup>173</sup> Mr. Cox further estimated that customers had saved “approximately 20%” because Bluegrass Water had refused to accept price increases.<sup>174</sup>

The Commission notes that Operator contract expense is Bluegrass Water’s largest expense, amounting to nearly \$1,000,000 per year. In Bluegrass Water’s last rate case, the Commission questioned Bluegrass Water’s selection of a single contractor, and voiced its concern that Midwest would always have an advantage in bidding contracts if Bluegrass Water was unable to start bidding them in larger groups.<sup>175</sup> However, the Commission allowed recovery of the operator contract expenses in that case, acknowledging that Bluegrass Water was acquiring systems piecemeal and Bluegrass Water would not be able to bid in larger groups at that time.<sup>176</sup> The Commission made clear its expectations that Bluegrass Water would experience future savings through the bid process, and directed Bluegrass Water to follow through on a plan to request bids for operator contracts based upon geography for all systems together to take advantage of economies of scale or regional benefits.<sup>177</sup>

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<sup>172</sup> HVT of the Sept. 19, 2023 Hearing, Cox Testimony, at 4:37.

<sup>173</sup> Bluegrass Water’s Post-Hearing Brief at 32; See also Bluegrass Water’s Response to Staff’s Second Request, Exhibit PSC 2-19.

<sup>174</sup> HVT of the Sept. 19, 2023 Hearing, Cox Testimony, at 4:38.

<sup>175</sup> Case No. 2020-00290, Aug. 2, 2021 Order at 69.

<sup>176</sup> Case No. 2020-00290, Aug. 2, 2021 Order at 69.

<sup>177</sup> Case No. 2020-00290, Aug. 2, 2021 Order at 69-70.

Bluegrass Water provided documentation in this proceeding that RFQ's had been sent to multiple bidders, however, as Mr. Cox testified, Bluegrass Water's inquiries to other operations companies requesting bids in geographic blocks were unsuccessful.<sup>178</sup> Ultimately, it appears that only Bluegrass Water's current contractor was able to obtain the requisite qualification under the RFQ process, to then bid on contracting for operations of Bluegrass Water's systems through the RFP process.<sup>179</sup> Bluegrass Water admitted it had not met the expectation of obtaining bids for contracts on a geographical basis, and that the previously anticipated savings had not been realized from economies of scale.<sup>180</sup> Bluegrass Water instead indicated that it would need to purchase a number of more systems to work towards those goals in the future.<sup>181</sup>

Bluegrass Water further claimed that it would not be able to bring operations in-house, for less than it pays to Midwest, given the necessary qualified personnel and equipment it anticipates it would be required for each system.<sup>182</sup>

The Commission acknowledges that Bluegrass Water has been able to contain its operator costs in its most recent extension of those contracts with Midwest, and finds that the operator contracts are a necessary expense to ensure the provision of safe and reliable service by Bluegrass Water and should be approved. However, the Commission would continue to voice its concern, especially given the magnitude of this expense, that

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<sup>178</sup> HVT of the Sept. 19, 2023 Hearing, Cox Hearing Testimony, at 04:37.

<sup>179</sup> Bluegrass Water's Response to Staff's Request, Exhibit - provides copies of multiple RFQ's that were sent to various operations companies, yet, as the testimony provides, the only bid Bluegrass actually received was from Midwest.

<sup>180</sup> HVT of the Sept. 19, 2023 Hearing, Cox Hearing Testimony at 04:50.

<sup>181</sup> HVT of the Sept. 19, 2023 Hearing, Cox Hearing Testimony at 04:58.

<sup>182</sup> HVT of the Sept. 19, 2023 Hearing, Cox Hearing Testimony, at 04:54.

Bluegrass Water has failed to achieve any further progress towards the expectation that operator contracts could be bid regionally in order to take advantage of economies of scale. Despite Bluegrass Water's assertions in the opposite, the Commission also questions whether Bluegrass Water might be able to realize savings by bringing its operations in-house, and would direct Bluegrass Water to consider that option, or provide a study to evidence the potential cost of that option in any future rate proceedings.

### Bad Debt Expense

Bluegrass Water maintains an allowance for doubtful accounts. An accrual is made to the allowance every month. Direct write-offs occur annually and reduce the allowance by a net amount.<sup>183</sup> Bluegrass Water stated it has historically experienced a bad debt expense of 1 percent of gross revenues. This is the amount Bluegrass uses for planning purposes.<sup>184</sup>

Attorney General Witness Dittmore proposed a Bad Debt expense of \$2,529.<sup>185</sup> This represents the amount of written-off accounts during 2022.<sup>186</sup> Dittmore states that Bluegrass did not support its level of Bad Debt expense for two reasons; first, the trial balance reflects that the credits to Bluegrass Water's Accumulated Provision for Uncollectable Accounts contain credits of approximately \$34,000 which is not identical to the test period bad debt expense of \$32,027. Secondly, Bluegrass Water stated they had

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<sup>183</sup> Response to Attorney General's First Request, Item 117.

<sup>184</sup> Application, Exhibit 10, Application\_Exhibit\_10\_-\_Direct\_Testimony\_of\_Brent\_Thies.pdf, at 13.

<sup>185</sup> Testimony of David Dittmore, Dittmore\_Public\_Testimony\_Combined.pdf, at 21.

<sup>186</sup> Response to Attorney General's Second Request, Item 14b, Exhibit\_OAG\_2-14(b)\_-\_Direct\_Write\_Off.xlsx.

no significant analytical support.<sup>187</sup> Bluegrass Water stated “the percentage and the methodology have been reviewed by management and deemed sufficient based upon their experience in the industry until such time as the company has more historic, post-Covid-19 data on collections and past due balances.”<sup>188</sup>

In its rebuttal testimony, Bluegrass Water did not agree with the Attorney General’s calculation of bad debt for two reasons. First, Bluegrass Water stated they recognized and recorded \$33,382 for the sewer system’s bad debt during the test year. Second, Bluegrass Water utilizes the allowance methodology in order to match revenue and expenses and assign cost with the customers to whom service is provided in the same period in which it is provided. With the allowance methodology, no further expense will need to be booked.<sup>189</sup>

Bluegrass Water began recording revenue accruals in October 2022 as a month end closed improvement process. Therefore there is no historic record to determine if the use of a one percent accrual is historically appropriate.<sup>190</sup> Since Bluegrass Water utilized a historic test year for this case, the Commission reviewed the last three years of bad debt write-offs in order to determine if a one percent allowance was appropriate. The Commission determined that in none of the three previous years a one percent uncollectable allowance was appropriate based on the amount actually written off. In

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<sup>187</sup> Bluegrass Water’s Response to Attorney General’s Second Request, Item 63.

<sup>188</sup> Bluegrass Water’s Response to Attorney General’s First Request, Item 116.

<sup>189</sup> Thies Rebuttal Testimony at 20-22.

<sup>190</sup> Bluegrass Water’s Response to Attorney General’s Second Request, Item 14a.

2020, \$68 was written off; in 2021 \$1,419; and in 2022, \$2,529 was written off.<sup>191</sup> The Commission does not agree that a one percent allowance for bad debt matched the past three year's actual write-offs. Therefore, the Commission agrees with the Attorney General's position to use the direct write off method to determine bad debt, and to set bad debt at \$2,529 in order to match the test year's actual write-offs; resulting in a decrease to Bad Debt expense of \$29,498, as shown in the following table.

In addition, since the Commission does not agree with the use of one percent bad debt, this reduces the gross up factor needed for the determination of the Revenue Requirement. The Gross Revenue Conversion Factor is reduced from 1.0101 to 1.0011; and the Gross Income Conversion Factor is reduced from 1.3459 to 1.3339, as shown in the following tables. The changes in the Gross-up factor results in a decrease to revenue requirement of \$4,853.

<u>Gross Revenue Conversion Factor Calculation</u>	<u>Total Rate</u>	<u>Conversion Factor Percentage</u>	<u>Total Conversion Factor</u>
Gross Income from Revenue		100%	
Less: Bad Debt	0.11%	0.11%	100%
Net Income After Bad Debt		<u>99.89%</u>	
Gross Revenue Conversion Factor (1/Line 12)		<u><u>1.0011</u></u>	

<sup>191</sup> Response to Attorney General's Second Request, Item 14b, Exhibit\_OAG\_2-14(b)\_-\_Direct\_Write\_Off.xlsx.

<u>Gross Income Conversion Factor Calculation</u>	<u>Total Rate</u>	<u>Conversion Factor Percentage</u>	<u>Total Conversion Factor</u>
Gross Income from Revenue		100%	
Less: Bad Debt	0.11%	<u>0.11%</u>	3.89%
Net Income After Bad Debt		<u>99.89%</u>	
Less: State Income Tax @ 5.0%	5.00%	4.99465911%	19.26%
Net Income After Bad Debt and State Tax		<u>94.898523%</u>	
Less: Federal Income Tax @ 21%	21.00%	<u>19.93%</u>	<u>76.85%</u>
Net Income After Bad Debt, State and Federal Income Taxes:		<u>74.97%</u>	<u>100%</u>
Operating Income Conversion Factor (1/Line 12)		<u>1.3339</u>	

### Property and Liability Insurance Expense

Bluegrass Water included \$224,836 in insurance expense in the revenue requirement for Bluegrass Water. The Attorney General's Witness, Dittmore, recommended a decrease to insurance expense of \$89,411, resulting in insurance expense of \$135,426, based on a reduction in the insurance expense since January 2023. In rebuttal, Bluegrass Water acknowledged the reduction in insurance expense and agreed with the Attorney General's adjustment reducing insurance, though it applied the 1.01 gross up factor for bad debt expense that Bluegrass Water applied to its entire revenue requirement.

The Commission agrees with the Attorney General's proposed adjustment reducing insurance expense in the amount of \$89,411, because the evidence indicates a decrease in insurance expense occurred. Further, there is no need to gross up this adjustment as Bluegrass Water did in its rebuttal, because the Commission eliminated Bluegrass Water's gross up for bad debt for the reasons discussed above such that

removing a portion of it again here would result in the same cost being eliminated twice. Thus, based on the evidence provided by the Attorney General and Bluegrass Water's rebuttal, the Commission finds that Bluegrass Water's revenue requirement should be reduced by \$89,411 to reflect the reduction in insurance expense.

The Commission also finds that an additional reduction is necessary to eliminate those portions of the premiums paid for Business Interruption Insurance. While Bluegrass Water indicates that portions of insurance expense paid for Business Interruption Insurance benefit customers by providing funds to continue operations in the event of a natural disaster, the insurance is designed specifically to insure all or a portion of Bluegrass Water's profits. "Cost-based rates for investor owned utilities are set at a level to allow the utility to recover all of its reasonable expenses and provide its shareholders an opportunity to earn a fair return on invested capital."<sup>192</sup> Ratepayers are not the guarantors of a utility's profit. Thus, the Commission finds that it is unreasonable for an investor-owned utility to recover the cost of insuring profits from ratepayers, and therefore, finds that Bluegrass Water's insurance expense should be further reduced by \$12,260.<sup>193</sup>

#### Adjustment Related to change in customer information/billing System.

In the application, Bluegrass Water proposed an adjustment to decrease OSS-IT expense by \$10,555 to reflect Bluegrass Water's contract with the provider of its customer information and billing system expiring in early 2022. In anticipation of this Bluegrass Water sought to negotiate a new contract with its provider while also seeking quotes from

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<sup>192</sup> Case No. 2021-00028, *Electronic Application of Louisville Gas and electric Company for Modification of its Performance-Based Ratemaking Mechanism* (Ky. PSC Nov. 29, 2021), Order at 5.

<sup>193</sup> This amount was calculated based on a confidential spreadsheet filed by Bluegrass Water, and the method was discussed during the confidential session of the hearing at which time Bluegrass Water's witness, Brent Thies indicated the method.

new software providers. The cost for the Muni-Link software is charged to Central State Water Resource (CSWR), LLC on a per-customer basis based on the total customer count for all CSWR operating affiliates. This total cost is then jointly charged to the individual state utility operating companies, like Bluegrass Water, based on the number of customer connections for that operating company.<sup>194</sup> This change results in a reduction of test-year expense totaling \$10,555.<sup>195</sup>

In its testimony, the Attorney General Witness Dittmore testified that he identified non-recurring charges related to the implementation, training, and data conversion costs associated with its vendor contract multi-Link, and the associated costs should be removed from Bluegrass Water's revenue requirement.<sup>196</sup> Bluegrass Water identified these non-recurring costs,<sup>197</sup> and confirmed that the implementation, training and data conversion fee is a one-time charge and is not an ongoing charge, nor is it representative of on-going charges.<sup>198</sup> As shown in the following table, witness Dittmore identified \$12,035 in costs that should be removed from the OSS – IT Expense. Bluegrass Water did not address or rebut these calculations or recommendations in its rebuttal testimony.

The Commission agrees with the Attorney General's position and finds that this adjustment is reasonable, since they are not routine transactions in the normal course of business and should be removed from the Revenue Requirement calculation, and should

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<sup>194</sup> Application, Exhibit 10, Application\_Exhibit\_10\_-\_Direct\_Testimony\_of\_Brent\_Thies.pdf, at 13.

<sup>195</sup> Application, Exhibit 10, Application\_Exhibit\_10\_-\_Direct\_Testimony\_of\_Brent\_Thies.pdf, BT-3.

<sup>196</sup> Dittmore Direct Testimony, Dittmore\_Public\_Testimony\_Combined.pdf, at 20 and Exhibit DND-8.

<sup>197</sup> Bluegrass Water's Response to Attorney General's First Request, Item 106, Exhibit\_OAG\_1-106\_-\_CSWR\_Nitor\_Muni-Link.xlsx

<sup>198</sup> Bluegrass Water's Response to Attorney General's First Request, Item 108,

be accepted. Therefore, an additional \$1,576 should be removed from the OSS – IT Expense for a total reduction of \$12,035.

Posting Date	Customer/ Vendor Name	Amount	Allocation Ratio	Total
3/1/2022	Link Computer Corporation	\$ 83,333	5.07%	\$ 4,227
4/5/2022	Link Computer Corporation	83,333	4.68%	3,904
5/18/2022	Link Computer Corporation	83,333	4.68%	3,904
Total Adjustment		<u>\$ 250,000</u>		<u>\$ 12,035</u>

Business Development Expenses.

Bluegrass Water states that CSWR excludes charges which are related exclusively to its business development activities from its indirect allocation expenses.<sup>199</sup> The Attorney General witness Dittmore stated Bluegrass Water indicates it has removed \$135,709 in CSWR Executive/Business Development costs from total CSWR General Ledger costs.<sup>200</sup> The Business Development costs are subtracted from total CSWR costs to arrive at net costs subject to applying the Company's general three-part allocation percentage. Based upon the line-item description in this calculation, the reader assumes that the Business Development line item reflects all costs identified and excluded by the Company, however, this is not the case. An examination of the response to AG 1-124 indicates that these Business Development exclusions are comprised of apparent employee travel expenses and the costs of third-party contractors and do not include any employee compensation.<sup>201</sup> The Business Development payroll represents

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<sup>199</sup> Application, Exhibit 10, Application\_Exhibit\_10\_-\_Direct\_Testimony\_of\_Brent\_Thies.pdf, at 15.

<sup>200</sup> Testimony of David Dittmore, Dittmore\_Public\_Testimony\_Combined.pdf, at 10.

<sup>201</sup> Bluegrass Water's Response to Attorney Generals First Request, Item 124.

11.28 percent of the total test period payroll. This ratio seems small given the scope of Bluegrass Water's acquisition efforts. CSWR supplied a list of employee's allocation of time dedicated to business development.<sup>202</sup>

In his rebuttal testimony, Mr. Thies states that Mr. Dittmore repeatedly makes reference to a failure to provide proof that business development costs were removed or eliminated, and that Mr. Dittmore fails to understand that business development costs were never allocated to Bluegrass Water in the first place; costs never allocated cannot be removed or eliminated.<sup>203</sup> Mr. Thies indicated that CSWR employees keep timesheets so that they may directly bill for business development expenses such that employee costs related to business development are not assigned to any CSWR operating utility, including Bluegrass Water. Therefore, Mr. Thies asserted that Bluegrass Water cannot show that business development expenses related to employee compensation was removed since they were never incurred by or allocated to Bluegrass Water.<sup>204</sup>

In its' post-hearing brief, the Attorney General argued that the Commission should reduce the revenue requirement to account for the business development activities that were not properly excluded from rates.<sup>205</sup>

Only nine Company employees charge time to business development functions, with those costs excluded from the corporate overhead allocated to the CSWR systems, including Bluegrass. For the five top executives of CSWR, the President, Senior Vice President, Vice President/Corporate

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<sup>202</sup> Bluegrass Water's Response to Attorney General's Supplemental Request (filed June 22, 2022), Item 26, Exhibit\_OAG\_2-26\_-\_Buisness\_Development\_salary.xlsx.

<sup>203</sup> Rebuttal Testimony of Brent Thies, Case\_No.\_2022-00432\_-\_Rebuttal\_Testimony\_of\_Brent\_Thies\_(Public).pdf at 8.

<sup>204</sup> Rebuttal Testimony of Brent Thies, Case\_No.\_2022-00432\_-\_Rebuttal\_Testimony\_of\_Brent\_Thies\_(Public).pdf at 9.

<sup>205</sup> Attorney General Post-Hearing Brief, (Filed Oct. 27, 2023), Item VII, at 11.

Controller, Vice President, and Chief Financial Officer, only 11% of their time is charged to the business development function. CSWR has 40 pending acquisitions in ten different jurisdictions. As the Commission is aware, acquisitions require significant due diligence, negotiation, and regulatory compliance efforts, just to name a few. It simply defies logic that such a small percentage of so few employees time is allocated to business development given the extraordinary scope of the Company's expansion. The Attorney General recognizes that identification of an accurate value to be considered business development expense and disallowed from recovery is difficult. However, the Company, which is the only party in control of the information that would allow such an accurate accounting to be made, has failed to provide the information. It should not be rewarded for that failure by setting rates based on a clearly erroneous value. Accordingly, the Commission should in its discretion reduce the revenue requirement to be paid by ratepayers to offset costs related to business development that are clearly intermingled with other costs. Further, the Commission should require Bluegrass to conduct an internal time study identifying time spent: (1) researching potential acquisition targets, (2) managing external vendors engaged in due diligence related to acquisitions, (3) negotiating purchase agreements, and (4) on regulatory filings related to acquisition cases, and any other issues the Commission deems relevant to this analysis. This study should be at the Company expense not recoverable from ratepayers.

In Bluegrass Water's Post Hearing Brief, Bluegrass' witness states they have appropriately excluded non-recoverable expenses, including business development expenses. In addition, Bluegrass Water states that it has removed all expense reports provided by Business Development employees and certain vendors whose primary purpose is related to the acquisition of new systems rather than ongoing business activities.<sup>206</sup> Bluegrass Water stated that the Attorney General's Witness Dittmore acknowledged at the hearing that "in fact, the costs claimed as business development

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<sup>206</sup> Bluegrass Water's Post Hearing Brief, Item vi at 31.

have been excluded”<sup>207</sup> and costs identified as business development have been excluded.

The Commission has concerns regarding the extent to which CSWR’s employees are engaging in business development that is not being recorded on their timesheets. The Commission agrees with the Attorney General that it is beyond suspicious that no employees other than executives coded time to business development despite Bluegrass Water’s extensive development activities, mostly in other states. However, there is no direct evidence that business development costs in other states are being allocated to Bluegrass Water’s customers and Bluegrass Water’s business development activities in Kentucky appear to have been limited based on the number of acquisitions during the test year. Further, the Commission is concerned about making an adjustment to remove business development expense with no basis for determining amounts that should be excluded, especially in light of other adjustments that the Commission believes are necessary in this matter. Thus, while the Commission would encourage CSWR to require its employees to specifically identify any work done for business development and may make adjustments in future rate cases if it fails to do so, the Commission declines to make an additional adjustment for business development expense at this time.

#### Health and Dental Insurance

For Health and Dental insurance benefits provided to employees, CSWR pays 99 percent of premiums, and the employees pay the remaining 1 percent.<sup>208</sup> In the test

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<sup>207</sup> HVT of the Sept. 20, 2023 Hearing, David N. Dittmore Testimony, 14:15:30.

<sup>208</sup> Bluegrass Water’s Response to Staff’s First Request, Item 16, Exhibit PSC 1-16- Employee Cost Data (Confidential).

year, for employees not designated as new positions, Bluegrass Water included Health and Dental employer contribution totals of \$776,423.<sup>209</sup>

Witness Dittmore proposed an adjustment to Bluegrass Water's expense for health and life insurance, citing changes in Bluegrass Water's expense and Commission precedent regarding the treatment of employee insurance benefit costs.<sup>210</sup> First, the Attorney General's witness obtained medical costs for the test period and months after the test period and indicated that medical cost increased after the test period. Then, the Attorney General's witness identified the most recent Bureau of Labor Statistics (BLS) data on employer contributions, identifying at a ratio of 78 percent.<sup>211</sup> The Attorney General's witness recommended an adjustment to the test period insurance expense to account for the increase in the expense in the first quarter of 2023 and to reduce the expense based on the BLS sharing percentages. That proposed adjustment resulted in a net increase in the revenue requirement in the amount of \$15,375.<sup>212</sup> Bluegrass Water made no objections or rebuttals to the proposed adjustment of the Attorney General's witness.

The Commission has placed greater emphasis on evaluating employee total compensation packages for market and geographic competitiveness to ensure fair rate development and has generally determined that 100 percent employer-funded health and

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<sup>209</sup> Bluegrass Water's Response to Staff's Second Request, Item 14, Schedule 2-PSC-14 (Confidential).xlsx.

<sup>210</sup> Testimony of David Dittmore, Dittmore\_Public\_Testimony\_Combined.pdf, at 23.

<sup>211</sup> Testimony of David Dittmore, Dittmore\_Public\_Testimony\_Combined.pdf, at 24 and 25.

<sup>212</sup> Testimony of David Dittmore, Dittmore\_Public\_Testimony\_Combined.pdf, at DNSD-11.

dental care does not meet that criteria.<sup>213</sup> In every general rate case filed since 2016 in which a utility sought to recover its expenses for the payment of 100 percent of its employees' health insurance premiums, the Commission has reduced test year expenses for health insurance premiums to levels based on national average employee contribution rates. It is Commission practice that, in the absence of any compensation policy or benefits study regarding insurance benefits, an adjustment should be made to employee insurance expense to bring the employee contributions in line with the BLS average employer contribution percentages for health insurance and the Willis Benefits Benchmarking Survey for dental insurance. The Commission does not see any material difference between a utility paying 99 percent of the premiums and 100 percent of the premiums.

While Bluegrass Water did obtain a wage and benefit study as part of this rate case, that study did not support CSWR's continued payment of 99 percent of employee's insurance benefits. Notably, the report actually indicated that CSWR is an outlier with respect to health insurance contributions when compared to the peer companies listed in the report, which all had employer/employee contribution rates of \$595/\$140, \$630/\$157, and \$588/\$105 for employee-only plans and lower contribution rates for family plans.<sup>214</sup>

The report indicated that other peer companies have even lower contribution rates for

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<sup>213</sup> See, e.g., Case No. 2016-00434, *Application of Shelby Energy Cooperative, Inc. for an Increase in its Retail Rates* (Ky. PSC July 1, 2017), final Order at 6-7; Case No. 2016-00367, *Application of Nolin Rural Electric Cooperative Corporation for a General Rate Increase* (Ky. PSC June 21, 2017), final Order at 10-11; Case No. 2016-00365, *Application of Farmers Rural Electric Cooperative Corporation for an Increase in Retail Rates* (Ky. PSC May 12, 2017), final Order at 6-7; Case No. 2016-00174, *Electronic Application of Licking Valley Electric Cooperative Corporation for a General Rate Increase* (Ky. PSC Mar. 1, 2017), final Order at 18; Case No. 2017-00349, *Electronic Application of Atmos Energy Corporation for an Adjustment of Rates and Tariff Modifications* (Ky. PSC May 3, 2018), final Order at 19.

<sup>214</sup> Application, Direct Testimony of Quentin M. Watkins, Exhibit A – Wage and Benefit Study (Wage and Benefit Study) at 9.

dental insurance. Thus, as in Bluegrass Water’s previous rate case, the Commission finds that Bluegrass Water’s contribution rates for employee insurance are unreasonably high, and therefore, should be adjusted as suggested by the Attorney General’s witness.

However, the Commission also recognizes that Bluegrass Water’s employee insurance expense went up after the test period. Accordingly, the Commission has increased Bluegrass Water’s historic period employer contributions for Health and Dental insurance by \$15,997, as shown below.

<u>Health Insurance Calculation</u>	
Total Jan-March 2023	\$ 337,484
Annualized 1Q 2023	1,349,937
BLS Survy Percent	<u>79%</u>
Eligible CSWR Costs	1,066,450
Test Period Wtd Allocation	<u>4.31%</u>
Pro Forma Bluegrass Allocated Expense	45,964
Less: Expense Charged to Bluegrass	<u>(29,967)</u>
Adjustment to Normalize Employee Benefit Costs	<u><u>\$ 15,997</u></u>

Executive Pay

Bluegrass Water stated that its operations are primarily located in or near the corridor that connects Lexington and Louisville, and the labor market in this area is comparable to St. Louis.<sup>215</sup> However, evidence derived from cross-examination at the hearing in this matter challenged that assertion.

Bluegrass Water’s compensation witnesses indicated that he believed salary increases of 3 to 6 percent were reasonable and indicated that Bluegrass Water’s overall

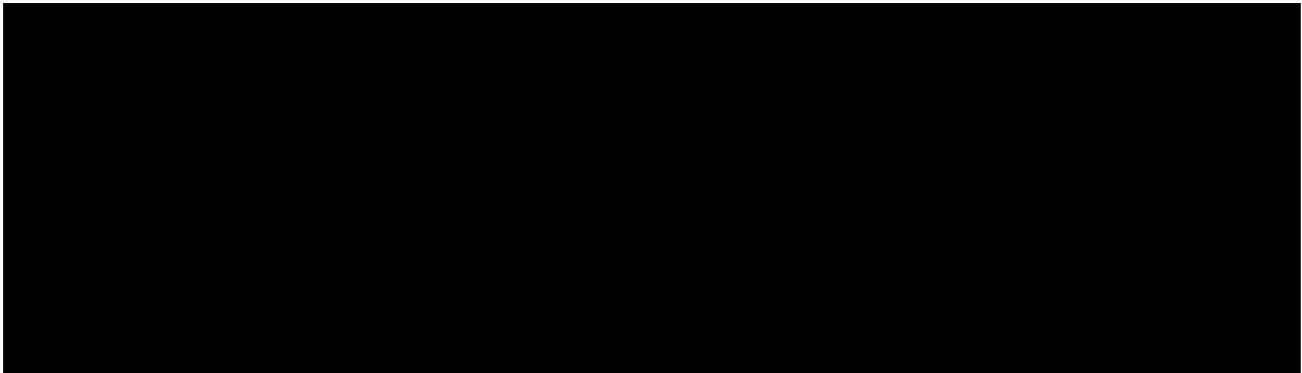
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<sup>215</sup> Application, Exhibit 12, Application\_Exhibit\_12\_Direct\_Testimony\_of\_Quentin\_M\_Watkins.pdf, at 4.

increases in salary expense were reasonable for that reason. However, Bluegrass Water's overall raises were in the range of 6 percent, but certain key executives received significantly higher annual increases for a number of years. The Commission limited Executive's annual increase to at most 3.5 percent. Bluegrass Water provided wage increase data in response to a post-hearing data request. The Commission calculated any disallowable wages based on the Commission's decision of appropriate increases. The Commission calculated the CSWR Executive Salaries total with a 3.5 percent increase, then allocated the salaries to Bluegrass Water.

In order to determine the amount of executive salaries included in the test year, the Commission identified the 2021 and 2022 salaries, since the test year for the rate case is July 1, 2021, through June 30, 2022, the Commission averaged each CSWR executives' salaries then allocated the average to Bluegrass based on the allocation factors. The total result is a test year allocated executive salaries of \$117,136.

Therefore, the Commission calculated an allocated executive salary for Bluegrass Water of \$112,824, which results in a decrease to Allocated Overhead of \$4,312 as shown in the following table.



## Interest Expense

In the application, Bluegrass Water proposed an adjustment to increase Interest Expense by \$168,717.<sup>216</sup> Bluegrass Water calculated this adjustment by multiplying the Proposed Rate Base of \$6,388,068 by the Long Term Debt Capital Structure percentage of 38.84 percent and the Current Cost of Debt of 6.80 percent, resulting in an interest expense of \$168,717<sup>217</sup> as shown in the following table.

The Commission, when adjustments are taken into account, determined a rate base of 4,199,357, as well as a different Long Term Debt Capital Structure percentage of 50.00 percent Capital as ordered previously.<sup>218</sup> Therefore the Commission calculated an interest expense of \$142,778, which is \$25,938 less than Bluegrass Water's proposed \$168,717 as shown in the following table.

	Bluegrass Water Proposed	Commission Approved
Rate Base	\$ 6,388,068	\$ 4,199,357
Multiplied by: Capital Structure	38.84%	50.00%
Multiplied by: Cost of Debt	6.80%	6.80%
Interest Expense	<u>\$ 168,717</u>	<u>142,778</u>
Change in Interest Expense		<u>\$ (25,938)</u>

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<sup>216</sup> Application, Exhibit 10, Application\_Exhibit\_10\_-\_Direct\_Testimony\_of\_Brent\_Thies. BT-3. And Application, Exhibit 25.

<sup>217</sup> Bluegrass Water's Response to Attorney Generals First Request, Item 113, Exhibit\_OAG\_1-113\_-\_Known\_Measurable\_Adjustment\_Explinations\_(1).xlsx, Interest & Depr Cal tab, Cell F4.

<sup>218</sup> Case No. 2019-00104, *Electronic Application of Bluegrass Water Utility Operating Company, LLC for Issuance of Evidence Of Indebtedness*, Final Order (Ky. PSC Aug. 14, 2019), at 18.

## PRO FORMA ADJUSTMENTS SUMMARY

The effect of the Commission's adjustments on Bluegrass Water's pro forma test-period operations for the sewer division is below. The chart in Appendix A, attached to this Order, is a detailed water pro forma Income Statement that shows the effect of the Commission's adjustments along with the proposed and accepted adjustments of Bluegrass Water for its sewer division.

	Bluegrass Water's Test Year Ended June 30,2022	Total Proposed Known & Measurable Adjustments	Commission Approved Proposed Pro Forma
Total Other Operating Revenues	\$ 2,358,858	\$ 8,725	\$ 2,367,583
Total Operating Expenses	2,685,931	(206,401)	2,479,530
Gross Operating Income	(327,073)	215,126	(111,947)
Less: Interest Expense	-	142,778	142,778
Net Income	<u>\$ (327,073)</u>	<u>\$ 72,347</u>	<u>\$ (254,726)</u>

## RATE OF RETURN

### Capital Structure

Bluegrass Water proposed a capital structure comprised of 61.16 percent common equity with a proposed return on equity (ROE) of 11.65 percent and 38.84 percent long-term debt at an embedded cost rate of 6.80 percent. In Case No. 2020-00290,<sup>219</sup> Bluegrass Water proposed a hypothetical capital structure consisting of 50 percent equity and 50 percent long-term debt. In that same case, the Commission ordered that a hypothetical capital structure consisting of 50 percent long-term debt and 50 percent equity to be reasonable considering Bluegrass Water's actual capital structure at that time

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<sup>219</sup> Case No. 2020-00290, *Electronic Application of Bluegrass Water Utility Operating Company, LLC for an Adjustment of Rates and Approval of Construction* (Ky. PSC Oct. 1, 2020).

was approximates 100 percent equity and zero debt. The Commission found that a capital structure that approximates 100 percent equity is not typical nor reasonable for ratemaking purposes. Since Bluegrass Water’s 2020 rate case, Bluegrass has incurred commercial debt. The proposed long-term debt reflects the Balance of Notes Payable with an amount of \$2,900,000,<sup>220</sup> which the Commission approved in Case No. 2022-00217.<sup>221</sup> Below is a table showing Bluegrass Water’s proposed capital structure in the present proceeding:<sup>222</sup>

<u>Type Of Capital</u>	<u>Ratios</u>	<u>Cost Rate</u>	<u>Weighted Cost Rate</u>
Long Term Debt	38.840%	6.800%	2.641%
Common Equity	<u>61.160%</u>	11.650%	<u>7.125%</u>
Total	<u>100.000%</u>		<u>9.766%</u>

The Attorney General’s witness, David Dittmore, reviewed Bluegrass Water’s Capital Structure testimony and recommended three options that the Commission should take under consideration. In the first scenario, Mr. Dittmore incorporated a capitalization ratio of 50 percent long-term debt with Bluegrass Water’s proposed long-term debt rate of 6.80 percent and 50 percent common equity with Bluegrass Water’s proposed ROE of 11.65 percent. This scenario produced an overall rate of return of 9.23 percent and a pre-tax cost of capital 11.16 percent.<sup>223</sup> In the second scenario, Mr. Dittmore directly

<sup>220</sup> Direct Testimony of Dylan D’Ascendis (D’Ascendis Direct Testimony), Exhibit DWD-3, at 1.

<sup>221</sup> Case No. 2022-00217, *Electronic Application of Bluegrass Water Utility Company Operating Company, LLC for Issuance of Evidence of Indebtedness* (Ky. PSC Sept. 28, 2022), Order.

<sup>222</sup> D’Ascendis Direct Testimony, Table 1, at 3.

<sup>223</sup> Dittmore Direct Testimony at 28.

assigned \$2,481,126 to debt, in which Mr. Dittmore explained is Bluegrass Water's supported level of debt in its Capital Structure, and the residual capitalization necessary to fund Rate Base was split evenly between debt and equity, which resulted in an overall capitalization ratio of 27.69 percent common equity and 72.31 percent long-term debt.<sup>224</sup> Mr. Dittmore explained that by maintaining Bluegrass Water's proposed 6.80 percent cost of debt and 11.65 percent ROE, this scenario produced an overall rate of return of 8.14 percent, with a pre-tax cost of capital of 9.22 percent.<sup>225</sup> In the third scenario, Mr. Dittmore adopted the same capitalization ratios utilized in the second scenario, but incorporated an ROE of 9.90 percent, as authorized by the Commission in Case 2020-00290.<sup>226</sup> The third scenario produced an overall rate of return of 7.66 percent, with a pre-tax cost of capital of 8.57 percent.<sup>227</sup> From these three scenario's, Mr. Dittmore recommended the third scenario be adopted because it recognizes the practical reality that not all funding provided by an investor will necessarily be equity and makes the reasonable assumption that such financing is proportional between debt and equity.<sup>228</sup> The table below shows the Attorney General's recommended capital structure and cost rates:<sup>229</sup>

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<sup>224</sup> Dittmore Direct Testimony, at 26.

<sup>225</sup> Dittmore Direct Testimony, at 29.

<sup>226</sup> Case No. 2020-00290, *Electronic Application of Bluegrass Water Utility Operating Company, LLC for an Adjustment of Rates and Approval of Construction* (Ky. PSC Aug. 2, 2021), Order.

<sup>227</sup> Dittmore Direct Testimony, at 29.

<sup>228</sup> Dittmore Direct Testimony, at 29.

<sup>229</sup> Dittmore Direct Testimony, Exhibit DND-12.

Type of Capital	Amount	Ratios	Cost Rate	Weighted Cost Rate	Gross-Up Factor
Long-Term Debt	\$4,020,563	72.31%	6.80%	2.64%	4.92%
Common Equity	1,539,437	27.69%	11.65%	7.13%	3.65%
Total	<u>\$5,560,000</u>	<u>100.00%</u>		<u>9.77%</u>	<u>8.57%</u>

In addition, Mr. Dittmore explained how double leveraging has the potential to maximize returns for a regulated utility.<sup>230</sup> Mr. Dittmore expressed concern that Bluegrass Water's Balance Sheet included a Long-Term Liabilities Payable to Associate Companies amount of \$8,513,372 that was not being included in its proposed capital structure.<sup>231</sup> Mr. Dittmore explained that the risk from the use of a hypothetical capital structure to establish rates is that the parent company will maximize its use of debt, which is subsequently 'counted' as equity in its Bluegrass Water subsidiaries rate-setting process.<sup>232</sup> Mr. Dittmore explained that the transformation of debt-to-equity return may occur when regulators adopt an industry average capitalization methodology.<sup>233</sup> Mr. Dittmore stated that this regulatory issue may occur when a hypothetical capital structure or a subsidiary entity's capital structure is used and the capital provided by a parent company to a subsidiary is recognized as equity on the subsidiary's books, regardless of its true source.<sup>234</sup>

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<sup>230</sup> Supplemental Testimony of David N. Dittmore (Dittmore Supplemental Testimony), at 5.

<sup>231</sup> See Bluegrass Water's Response to Staff's First Request, Item 27.

<sup>232</sup> Dittmore Supplemental Testimony at 5. This process is known as double leveraging.

<sup>233</sup> Dittmore Supplemental Testimony at 5.

<sup>234</sup> Dittmore Supplemental Testimony at 5.

Mr. Dittmore illustrated how double leveraging can maximize equity returns for utility investors.<sup>235</sup> Mr. Dittmore explained that he included the full \$2,900,000 of Bluegrass Notes Payable to the Capital Structure amount in the capital structure and attributed an embedded cost rate of 6.80 percent, which was the same value Bluegrass Water used to compute its Capitalization Ratio for Long-Term Debt. Mr. Dittmore stated that he used an assumption that the remaining capital structure balance necessary to finance Rate Base comprised of 75 percent long-term debt and 25 percent common equity. Mr. Dittmore stated that the result produced an overall rate of return of 8.02 percent and that the level of equity financing Rate Base under his illustration was \$872,000. Mr. Dittmore explained that the \$775,000 return, based on Bluegrass Water's proposed capital structure, less Interest Expense based upon the level of debt in the imputed capital structure, produced an ROE amount of \$400,000, or approximately \$300,000 net of income taxes and that the Net Income of \$300,000 applied to the imputed equity return produces an overall ROE of 34.43 percent.<sup>236</sup>

Mr. Dittmore provided an additional alternative capital structure option for the Commission's consideration comprising the \$2,900,000 of Long-Term Liabilities Payable to Associated Companies, Bluegrass Water's long-term debt, and Common Equity. Mr. Dittmore explained that for this analysis, he applied a 6.80 percent cost rate to both Long-Term Liabilities Payable to Associated Companies and to the long-term debt. This resulted in an overall rate of return of 7.27 percent, with a pre-tax cost of capital of

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<sup>235</sup> Dittmore Supplemental Testimony at 5 and, Exhibit SDND-1.

<sup>236</sup> Dittmore Supplemental Testimony at 6.

7.77 percent.<sup>237</sup> The table below shows the Mr. Dittimore’s alternative capital structure and cost rates:<sup>238</sup>

Type of Capital	Amount	Ratios	Cost Rate	Weighted Cost Rate	Gross-Up Factor	Pre-Tax Cost
Long-Term Debt	\$2,900,000	21.54%	6.80%	1.46%	1.0000	1.46%
Long-Term Liabilities Payable to Associated Companies	8,513,372	63.24%	6.80%	4.30%	1.0000	4.30%
Common Equity	2,047,639	15.21%	9.90%	1.51%	1.3324	2.01%
Total	<u>\$13,461,011</u>	<u>100.00%</u>		<u>7.27%</u>		<u>7.77%</u>

In rebuttal testimony, Mr. D’Ascendis stated that Mr. Dittimore’s recommended capital structure is flawed because it is not representative of a regulated sewer utility and that the assumptions that Mr. Dittimore makes to conclude his recommended capital structure are not supported. Additionally, Mr. D’Ascendis stated that the reasoning Mr. Dittimore used to reject Bluegrass Water’s recommended capital structure, including the alleged double leverage capital structure, is flawed.<sup>239</sup>

Mr. D’Ascendis explained that there seemed to be confusion regarding which capital structure Mr. Dittimore is recommending, considering Mr. Dittimore proposed a capital structure that consists of 72.31 percent long-term debt and 27.69 percent common equity in his direct testimony and an alternative capital structure composed of 84.79 percent long-term debt and 15.21 percent common equity in his supplemental testimony.<sup>240</sup> Mr. D’Ascendis explained that neither of Mr. Dittimore’s capital structures are representative of regulated water companies and that the range of equity ratios

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<sup>237</sup> Dittimore Supplemental Testimony at 7-8.

<sup>238</sup> Dittimore Supplemental Testimony, Exhibit SDND-2.

<sup>239</sup> Rebuttal Testimony of Dylan W. D’Ascendis (D’Ascendis Rebuttal Testimony) at 2.

<sup>240</sup> D’Ascendis Rebuttal Testimony at 2.

maintained by the Utility Proxy Group was from 40.31 percent to 62.44 percent.<sup>241</sup> In addition, Mr. D'Ascendis explained that a hypothetical capital structure is not appropriate because as noted by David C. Parcell's text, *The Cost of Capital – A Practitioner's Guide*, there are circumstances where a hypothetical capital structure is used in favor of an actual or expected capital structure.<sup>242</sup> Mr. D'Ascendis explained that a hypothetical capital structure is not applicable because Bluegrass Water's capital structure is within the range set by typical or "proper" capital structures of comparable water utilities and Bluegrass Water operates solely as a water and sewer utility.<sup>243</sup>

Mr. D'Ascendis further explained that Mr. Dittimore's double leverage argument assumes the required return depends on the source of financing, not on the risks of the underlying utility operations and that if the common equity of a subsidiary were held by both the parent and an external investor, the equity held by the parent would have one required return, and the equity held by outside investors would have another.<sup>244</sup> Mr. D'Ascendis referenced sources he used as support to dismiss Mr. Dittimore's double leveraged arguments.<sup>245</sup>

The Attorney General explained in its Post-Hearing Brief, that it sought information related to the Bluegrass Water's relationship with US Water, LLC, the entity represented

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<sup>241</sup> D'Ascendis Rebuttal Testimony at 3.

<sup>242</sup> D'Ascendis Rebuttal Testimony at 4.

<sup>243</sup> D'Ascendis Rebuttal Testimony at 4.

<sup>244</sup> D'Ascendis Rebuttal Testimony at 7.

<sup>245</sup> D'Ascendis Rebuttal Testimony at 7-8. See also Roger Morin, *Modern Regulatory Finance*; Richard Pettway and Bradford Jordan, *Diversification, Double Leverage, and the Cost of Capital*; Michael Rozeff, *Modified Double Leverage – A New Approach*; Eugene Lerner, *What are the Real Double Leverage Problems*; Richard Brealey, Steward Meyers, and Franklin Allen, *Principles of Corporate Finance*, Alan Shapiro, *Modern Corporate Finance*.

as Bluegrass Water's ultimate parent company. Despite Commission Orders to produce the requested information, Bluegrass Water repeatedly failed to disclose the necessary financial documentation related to US Water, LLC, which necessitated the issuance of subpoenas. Additionally, the Attorney General explained that Bluegrass Water acknowledged that CSWR is Bluegrass Water's parent company and insisted that US Water, LLC is simply an investor, and is outside the Commission's jurisdiction.<sup>246</sup> The Attorney General noted that Mr. D'Ascendis's and Bluegrass Water's proposed capital structure is just as hypothetical as Mr. Dittimore's due to Bluegrass Water failing to provide evidence to support that the costs at issue are actually equity and not debt.<sup>247</sup>

In Bluegrass Water's Post-Hearing Brief, it reaffirmed its capital structure proposal which consisted of 61.16 percent common equity and 38.84 percent long-term debt considering Bluegrass Water's actual capital structure is within the range of common equity ratios of the utility proxy group utilized by Mr. D'Ascendis.<sup>248</sup> Also, Bluegrass Water stated that its current actual debt ratio is based upon its outstanding loan amount of \$2,900,000 and that although the Commission previously approved Bluegrass Water to borrow up to \$5,000,000, the lender determined that Bluegrass Water's cash flows could not support a \$5,000,000 credit extension and therefore, Bluegrass Water borrowed the amount that its current cash flows could support.<sup>249</sup> Finally, Bluegrass Water explained that the requested rates in this case, including utilization of Bluegrass Water's actual

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<sup>246</sup> Attorney General's Post-Hearing Brief at 14.

<sup>247</sup> Attorney General's Post-Hearing Brief at 16.

<sup>248</sup> Bluegrass Water's Post-Hearing Brief at 35.

<sup>249</sup> Bluegrass Water's Post-Hearing Brief at 36.

capital structure, will allow Bluegrass Water the necessary cash flows to seek to obtain additional debt, which will move Bluegrass Water closer towards the actual 50 percent long-term debt to 50 percent common equity capital structure that Bluegrass Water seeks to achieve.<sup>250</sup>

The Commission has an expectation that utilities in Kentucky should have a capital structure that is reasonably balanced such that it does not over burden its ratepayers to the benefit of shareholders or engage in excess risk.<sup>251</sup> In apparent recognition of that expectation, Bluegrass Water supported its initial request to purchase systems and begin operating a utility in Kentucky by indicating its intent to maintain a capital structure with at least 50 percent debt financing,<sup>252</sup> Bluegrass Water's acquisition of systems in Kentucky has been conditioned on Bluegrass Water meeting that commitment.<sup>253</sup> For instance, in Case No. 2019-00104,<sup>254</sup> the Commission stated:

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<sup>250</sup> Bluegrass Water's Post-Hearing Brief at 36.

<sup>251</sup> See Case No. 2022-00372, *Electronic Application of Duke Energy Kentucky, Inc. For (1) an Adjustment of Electric Rates; (2) Approval of New Tariffs; (3) Approval of Accounting Practices to Establish Regulatory Assets and Liabilities; and (4) All Other Required Approvals and Relief* (Ky. PSC Oct. 12, 2023), Order at 35

<sup>252</sup> Case No. 2019-00104, *Electronic Proposed Acquisition by Bluegrass Water Utility Operating Company, LLC and the Transfer of Ownership and Control of Assets by P.R. Wastewater Management, Inc., Marshall County Environmental Services, LLC, LH Treatment Company, LLC, Kingswood Development, Inc., Airview Utilities, LLC, Brocklyn Utilities, LLC, Fox Run Utilities, LLC, Brocklyn Utilities, LLC, and Lake Columbia Utilities, Inc.* (Ky. PSC. Aug. 14, 2019), Order at 18.

<sup>253</sup> See Case No. 2020-00297, *Electronic Proposed Acquisition by Bluegrass Water Utility Operating Company, LLC and the Transfer of Ownership and Control of Assets by: Delaplain Disposal Company; Herrington Haven Wastewater Company, Inc.; Springcrest Sewer Company, Inc; and Woodland Acres Utilities, LLC* (Ky. PSC Jan. 14, 2021), Order at 10; Case No. 2019-00360, *Electronic Proposed Acquisition by Bluegrass Water Utility Operating Company, LLC and the Transfer of Ownership and Control of Assets by Center Ridge Water District, Inc.; Joann Estates Utilities, Inc.; and River Bluffs, Inc.* (Ky. PSC Feb. 17, 2020), Order at 12; Case No. 2019-00104, Aug. 14, 2019 Order at 18.

<sup>254</sup> Case No. 2019-00104, *Electronic Proposed Acquisition by Bluegrass Water Utility Operating Company, LLC and the Transfer of Ownership and Control of Assets by P.R. Wastewater Management, Inc., Marshall County Environmental Services, LLC., LH Treatment Company, LLC, Kingswood Development, Inc., Airview Utilities, LLC, Brocklyn Utilities, LLC, Fox Run Utilities, LLC, and Lake Columbia Utilities, Inc.* (Ky. PSC Apr. 16, 2019), Order.

We also find that Bluegrass Water's equity-to-capitalization percentage should not exceed 50% and that every effort must be made to lower that percentage. If the equity-to-capital percentage exceeds 50%, Bluegrass Water shall notify the Commission in writing within 30 days of this occurring and submit to the Commission a detailed plan explaining how it will revise its capital structure to achieve its approved equity-to-capital ratio.

Based on that condition, Bluegrass Water filed its previous rate case based on a hypothetical capital structure of 50 percent debt and 50 percent equity. In cases in which Bluegrass Water requested a CPCN since the last rate case, the Commission has reiterated its expectation that Bluegrass Water meet the conditions of approval for the sale of the systems.<sup>255</sup>

The Commission notes that the issuance of \$2,900,000 in debt in compliance with the Commission's Order in Case No. 2022-00217<sup>256</sup> is a step in the direction towards a more balanced and realistic capital structure. In that same case, the Commission granted Bluegrass Water the authority to receive at least \$2,900,000 and up to \$5,000,000 in debt.<sup>257</sup> Bluegrass Water stated that, after ongoing conversations with CoBank, CoBank recommended that Bluegrass Water only borrow \$2,900,000, due to its current cash flow.<sup>258</sup> However, the Commission notes that Bluegrass Water has control over its efforts to obtain debt and equity and when to seek rate increases if necessary to obtain debt.

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<sup>255</sup> See, e.g. Case No. 2022-00104, *Electronic Application of Bluegrass Water Operating Company, LLC for Certificates of Convenience and Necessity for Projects at the Delaplain Site* (Ky. PSC Mar. 30, 2023), Order at 11-12.

<sup>256</sup> Case No. 2022-00217, *Electronic Application of Bluegrass Water Utility Company Operating Company, LLC for Issuance of Evidence of Indebtedness* (Ky. PSC Sept. 28, 2022), Order.

<sup>257</sup> Case No. 2022-00217, *Electronic Application of Bluegrass Water Utility Company Operating Company, LLC for Issuance of Evidence of Indebtedness* (Ky. PSC Sept. 28, 2022), Order.

<sup>258</sup> Bluegrass Water's Response to Staff's Third Request, Item 3.

Even though Bluegrass Water assumed the minimum authorized amount of long-term debt, the Commission continues to be concerned that the proposed 61.16 percent common equity percentage is unreasonably high. More importantly, Bluegrass Water has failed to meet the condition of the approval of its purchase of the systems, which informed the Commission's decision that Bluegrass Water and its parent had the financial integrity to operate the system and that allowing Bluegrass Water to do so would be in the public interest. Thus, the Commission finds that Bluegrass Water failed to establish that a capital structure with less than 50 percent debt is unreasonable.

The Commission shares the Attorney General's concern with Bluegrass Water's treatment of the Liabilities Payable to Associated Companies and also acknowledges that the manner in which it is being used raises the possibility that Bluegrass Water is engaging in double leveraging. Specifically, the Commission questions whether the balance of equity on the books of Bluegrass Water reflects the true character of the funding provided by its investors given the characterization of the debt as Liabilities Payable to Associated Companies in Bluegrass Water's Balance Sheet. However, the Commission is not persuaded that there is sufficient evidence to find that Bluegrass Water and its parents are engaging in double leveraging. Further, as discussed in more detail above, the Commission has already found that Bluegrass Water did not establish that a capital structure with less than 50 percent debt is reasonable. Thus, the Commission does not believe that any additional adjustment would be justified based on the alleged double leveraging, though in its next rate case, Bluegrass Water should provide sufficient evidence to explain why any amount classified as the Liabilities Payable to Associated Companies should not be considered debt and why it should not be included in Bluegrass

Water’s capital structure. For the reasons discussed above, the Commission finds that a hypothetical capital structure consisting of 50 percent long-term debt and 50 percent equity to be reasonable. Further, the Commission finds that the proposed long-term debt rate of 6.80 percent is reasonable and should be approved considering this was the rate that Bluegrass Water actually obtained during its debt financing. A 50/50 capital structure based on a 6.8 percent debt rate and the 11.65 percent equity rate as proposed by Bluegrass Water results in a weighted average cost of capital of about 9.23 percent as shown in the table below.

Bluegrass Water			
Type Of Capital	Ratios (1)	Cost Rate	Cost Rate
Long Term Debt	50.00%	6.80%	3.40%
Common Equity	50.00%	11.65%	5.825%
Total	<u>100.00%</u>		<u>9.23%</u>

This is a decrease of about 0.57 percent as compared to Bluegrass Water’s proposed weighted average cost of capital before any gross up for taxes.

Return on Equity

Mr. D’Ascendis, used several costs of equity models to develop his ROE recommendation, including: the Discounted Cash Flow (DCF) model, the Risk Premium Model (RPM), the Predictive Risk Premium Model (PRPM), and the Capital Asset Pricing Model (CAPM).<sup>259</sup> These models were applied to six water companies known as the utility proxy group. Mr. D’Ascendis noted that the Commission has rejected the use of

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<sup>259</sup> D’Ascendis Direct Testimony at 3-4

the PRPM for estimating ROEs previously in Case No. 2021-00214<sup>260</sup> and that while he respectfully disagrees with the Commission's findings, he has presented the ROE model results including and excluding the PRPM for the Commission's convenience. The DCF ROE analysis utilized an adjusted average dividend yield added to an average projected 5-year earnings per share growth rate.<sup>261</sup> The RPM ROE analyses are based upon the predictive risk premium model (PRPM) and an adjusted total market approach.<sup>262</sup> The total market approach sums on a consensus forecast of approximately 50 economists of the expected yield on Aaa-rated corporate bonds for the six calendar quarters ending with the second calendar quarter of 2024, and the long-term projections for 2024 to 2028, and 2029 to 2033 to an estimated equity risk premium. The estimated total market equity risk premium is the average of an equity risk premium derived from a beta adjusted total market equity risk premium and an equity risk premium based on the Standard & Poor's (S&P) Utilities Index.<sup>263</sup> The CAPM analysis utilized an average forecast risk free rate based upon the 30-year treasury rate, and an average of Value Line and Bloomberg adjusted beta coefficients.<sup>264</sup> The estimated market risk premium is the result of six different estimation methods utilizing historical and forward-looking data from three

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<sup>260</sup> D'Ascendis Direct Testimony, at 27-28. See Case No. 2021-00214, *Electronic Application of Atmos Energy Corporation for an Adjustment of Rates* (Ky. PSC June 24, 2022), Order.

<sup>261</sup> D'Ascendis Direct Testimony at 21.

<sup>262</sup> D'Ascendis Direct Testimony at 22-24.

<sup>263</sup> D'Ascendis Direct Testimony at 28-29.

<sup>264</sup> D'Ascendis Direct Testimony at 38-39.

sources: Ibbotson, Value Line and Bloomberg. The following table represents a summary of Bluegrass Water’s ROE analysis:<sup>265</sup>

Discounted Cash Flow Model (DCF)	9.16%
Risk Premium Model (RPM)	12.09%
Capital Asset Pricing Model (CAPM)	11.58%
Market Models Applied to Comparable Risk, Non-Price Regulated Companies	<u>11.40%</u>
Rates before Adjustmtent for Company-Specific Risk	10.13% - 11.13%
Buisness Risk Adjustment	<u>1.00%</u>
Indicated Range of Common Equity Cost Rate after Adjustment	<u>11.13- 12.13%</u>
Recommended Common Equity Cost Rate	<u>11.65%</u>

Based upon the results of the analyses above, Bluegrass Water recommended an ROE of 11.65 percent based upon a range of 11.13 percent to 12.13 percent which included a specific additional 1.00 percent adjustment for business risk. The Commission notes that none of the parties in this case provided ROE testimony or separate analysis but that the Attorney General’s witness, Mr. Dittmore, utilized Bluegrass Water’s proposed ROE, 11.65 percent, and the previous awarded ROE, 9.90 percent, for the capital structure scenarios and supported the capital structure represented in the third scenario, which incorporates an ROE of 9.90 percent.

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<sup>265</sup> D’Ascendis Direct Testimony at 4. See D’Ascendis Direct Testimony, Exhibits DWD-4 and DWD-6.

In Mr. D'Ascendis rebuttal testimony, he stated that he disagrees with Mr. Dittimore's recommended 9.90 percent ROE.<sup>266</sup> Mr. Dittimore explained that authorized ROEs may be reasonable benchmarks of acceptable ROE's, but they do not reflect the current cost of common equity and that the reason why historical authorized returns do not reflect the investor-required return is because authorized ROE's are a lagging indicator of investor-required returns.<sup>267</sup> Mr. D'Ascendis provided a table that shows the indicated models results from this proceeding with those from Bluegrass Water's 2020 rate case.<sup>268</sup>

In the Attorney General's Post-Hearing Brief, the Attorney General recommended that the Commission should approve a reasonable, market-based return on equity that does not include the alleged company-specific business risk proposed by Bluegrass.<sup>269</sup> The Attorney General argued that Mr. D'Ascendis business risk adjustment is based in part on Bluegrass Water's size and that the impact of the size of the utility in setting an appropriate ROE should be tempered because ratepayers have no control over whether the system near their home is bought by a small or large operator.<sup>270</sup> The Attorney General also argued that the Commission should consider that Bluegrass Water's parent companies are large and control a more diversified portfolio of utilities and that if the utility's size affects business risk, the Commission should consider the true scope of the

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<sup>266</sup> D'Ascendis Rebuttal Testimony at 10.

<sup>267</sup> D'Ascendis Rebuttal Testimony at 10.

<sup>268</sup> D'Ascendis Rebuttal Testimony at 10.

<sup>269</sup> Attorney General's Post-Hearing Brief at 6.

<sup>270</sup> Attorney General's Post-Hearing Brief at 5.

company's operations, not just the capitalization of the relatively new venture in the Commonwealth.<sup>271</sup>

In Bluegrass Water's Post-Hearing Brief, Bluegrass Water stated that the Commission should approve the ROE of 11.65 percent proposed by Mr. D'Ascendis, which is the result of Mr. D'Ascendis study of the Utility Proxy Group and application of various models to arrive at a recommended return.<sup>272</sup> Additionally, Bluegrass Water noted that Mr. D'Ascendis further explained that it faces business risks that should be reflected in the authorized ROE and that the additional risks faced by Bluegrass Water takes various forms.<sup>273</sup> These risks include the fact that Bluegrass Water faces operational risk from acquisition of troubled water and wastewater systems, and that it is much smaller compared to the Utility Proxy Group.<sup>274</sup> Bluegrass Water also argued that even though the Attorney General's witness, Mr. Dittmore, did not perform a full rate of return analysis or otherwise recommend a specific ROE, the Commission should reject any suggestion by Mr. Dittmore that the Commission simply adopt the rate of return approved in Bluegrass Water's prior rate case.<sup>275</sup>

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<sup>271</sup> Attorney General's Post-Hearing Brief at 5.

<sup>272</sup> Bluegrass Water's Post-Hearing Brief at 39.

<sup>273</sup> Bluegrass Water's Post-Hearing Brief at 41.

<sup>274</sup> Bluegrass Water's Post-Hearing Brief at 41.

<sup>275</sup> Bluegrass Water's Post-Hearing Brief at 42.

The Commission notes that in recent cases including Case Nos. 2020-00174,<sup>276</sup> 2020-00349/350,<sup>277</sup> 2022-00147,<sup>278</sup> and 2022-00372,<sup>279</sup> the Commission has discussed that it is appropriate for utilities to present, and for the Commission to evaluate multiple methodologies to estimate ROEs, and each approach has its own strengths. As demonstrated in the respective ROE testimonies in this proceeding, there is considerable variation in both data and application within each modeling approach, which can lead to very different results. The Commission's role is to conduct a balanced analysis of all presented models, while giving weight to current economic conditions and trends.

Even though the Commission supports the use and presentation of multiple modeling approaches, the Commission continues to reject the use of the PRPM model to estimate a risk premium. The PRPM model has been only been addressed by three other regulatory commissions and is not universally accepted, and therefore, the Commission

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<sup>276</sup> See generally Case No. 2020-00174, *Electronic Application of Kentucky Power Company for (1) A General Adjustment of its Rates for Electric Service; (2) Approval of Tariffs and Riders; (3) Approval of Accounting Practices to Establish Regulatory Assets and Liabilities; (4) Approval of a Certificate of Public Convenience and Necessity; and (5) All Other Required Approvals and Relief*, (Ky. PSC Jan. 13, 2021).

<sup>277</sup> See generally Case No. 2020-00350 *Electronic Application of Louisville Gas and Electric Company for an Adjustment of its Electric and Gas Rates, A Certificate of Public Convenience and Necessity to Deploy Advanced Metering Infrastructure, Approval of Certain Regulatory and Accounting Treatments, and Establishment of a One-Year Surcredit*, (Ky. PSC June 30, 2021).

<sup>278</sup> See generally Case No. 2022-00147, *Electronic Application of Water Service Corporation of Kentucky for A General Adjustment in Existing Rates and A Certificate of Public Convenience and Necessity to Deploy Advanced Metering Infrastructure* (Ky. PSC June 13, 2022).

<sup>279</sup> See generally Case No. 2022-00372, *Electronic Application of Duke Energy Kentucky, Inc. For (1) an Adjustment of Electric Rates; (2) Approval of New Tariffs; (3) Approval of Accounting Practices to Establish Regulatory Assets and Liabilities; and (4) All Other Required Approvals and Relief* (Ky. PSC Dec. 14, 2022).

has rejected it in every preceding in which Mr. D'Ascendis has presented it.<sup>280</sup> Additionally, the Commission further reiterates that it continues to reject the use of flotation cost adjustments, financial risk adjustments and explicit size adjustments in the ROE analyses considering a business risk or size adjustment has not been approved in the past and the Commission agrees with the Attorney General on that matter. The Commission will accord most weight to DCF and CAPM analyses based upon regulated company proxy groups considering both the DCF and CAPM are both long standing and well accepted models.

Even though the use of a size adjustment is rejected in this case, the Commission takes note of several factors in determining an appropriate ROE for Bluegrass Water, including the risk from acquisition of troubled water and wastewater systems. After consideration of the evidence, the Commission finds that an ROE of 10.10 percent for Bluegrass Water's base rates is fair, just and reasonable for ratemaking purposes in this matter. The Commission notes that this approved ROE recognizes the unique risk associated with Bluegrass Water's business model, as it is higher than recent Commission awards, but is also reflective of the current economic environment.

With a 50/50 capital structure based on a 6.8 percent debt rate, changing the equity rate to 10.10 percent results in a weighted average cost of capital of 8.45 percent as shown in the table below.

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<sup>280</sup> See Case No. 2021-00214, *Electronic Application of Atmos Energy Corporation For An Adjustment of Rates* (Ky. PSC May 19, 2022) at 47-48; see also D'Ascendis Testimony at 24 ("Regarding the amount of times the model has been addressed in final orders; while it is true that only three (now four) regulatory commissions have addressed the PRPM in their final orders, the model has been presented in over 100 regulatory proceedings in over thirty U.S. regulatory jurisdictions and the Alberta Utilities Commission in Canada. This would indicate that while maybe not universally accepted, the model is widely disseminated across the U.S. regulatory landscape.").

Bluegrass Water			
<u>Type Of Capital</u>	<u>Ratios (1)</u>	<u>Cost Rate</u>	<u>Cost Rate</u>
Long Term Debt	50.00%	6.80%	3.40%
Common Equity	50.00%	10.10%	<u>5.050%</u>
Total	<u>100.00%</u>		<u>8.45%</u>

That represents an overall decrease of 1.35 percent as compared to Bluegrass Water’s proposed rate of 9.8 percent,<sup>281</sup> including a 0.76 percent increase in the weighted average cost of debt<sup>282</sup> and a 2.08 percent decrease in the weighted average cost of equity.<sup>283</sup> The change in the Weighted Average Cost of Capital results in a decrease to Revenue Requirement of about \$55,274.

### REVENUE REQUIREMENT

#### Authorized Increase - Sewer

The Commission finds that Bluegrass Water’s Revenue Requirement is \$2,905,451. The Commission further finds that this level of net operating income requires an increase in forecasted present rate revenues of \$537,868, or 22.7180 percent.

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<sup>281</sup> 9.8% - 8.45% = 1.35%.

<sup>282</sup> 3.40% - 2.64% = 0.76%.

<sup>283</sup> 5.05% - 7.13% = - 2.08%.

Revenue Requirement Determination

	Application	Commission Approved Adjustments	Adjusted Sewer
Total Original Cost Rate Base	\$ 6,388,068	\$ (2,188,711)	\$ 4,199,357
Operating Income at Present Rates	(503,865)	391,918	(111,947)
Earned Rate of Return	-7.89%		-2.67%
Requested Rate of Return	9.77%		8.45%
Required Return on Rate Base	623,875	(269,030)	354,846
Weighted Return on Equity	7.13%		5.05%
Operating Income Deficiency	1,127,741	(660,948)	466,793
Net Income Required for Return on Equity	455,159	(243,091)	212,068
Gross Revenue Conversion Factor	1.0101		1.0011
Gross Income Conversion Factor	1.3459		1.3339
Revenue Deficiency	1,291,976	(754,108)	537,868
Pro Forma Revenue at Present Rates	<u>2,435,594</u>	<u>(68,011)</u>	<u>2,367,583</u>
Total Revenue Requirement	<u>\$ 3,727,570</u>	<u>\$ (822,119)</u>	<u>\$ 2,905,451</u>
Percent Increase			<u>22.7180%</u>

RATE DESIGN

Unified Rate

Bluegrass Water proposes a unified, monthly flat rate for all residential wastewater customers, multi-family, and commercial customers based on a residential equivalency of \$99.37, \$74.53, and \$240.36, respectively.<sup>284</sup> Bluegrass Water is also proposing to increase the usage charge to its commercial customers in Delaplain from \$8.89 per 1,000

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<sup>284</sup> Application at 6.

gallons to \$14.91 per 1,000 gallons.<sup>285</sup> The proposed monthly flat rate design was adopted by Bluegrass Water as it mimics the rate design of the former individual systems it acquired. Bluegrass Water notes that the customers of Magruder Village Water Company, Commonwealth Wastewater System, LLC, Yung Farm Estate Homeowners Association, Inc., and Moon River Marina and Resort, LLC, which were acquired in recent acquisition cases, would not be subject to the proposed unified rate for all other systems.<sup>286</sup>

In support of its proposed unified rate, Bluegrass Water states that the Commission previously authorized the consolidation of its rates for wastewater service in Case No. 2020-00290.<sup>287</sup> In its final Order the Commission stated that “there are reasons for approving a unified rate as opposed to a single rate for each system, including that a unified rate is likely to promote regionalization, which should drive down costs in the long term by allowing utilities to take advantage of economies of scale, and that a unified rate will serve to levelized rates in the long term so that each system will not experience a significant rate shock every time it requires significant investment or some unexpected cost, which all systems will experience at some point. The Commission finds that the proposed unified monthly flat rate design, with wastewater multi-family dwellings and commercial customers monthly rates based on residential equivalency, should be approved for Bluegrass Water’s customers.”<sup>288</sup>

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<sup>285</sup> Application at 6.

<sup>286</sup> Bluegrass Water’s Post-Hearing Brief, footnote 172.

<sup>287</sup> Bluegrass Water’s Post-Hearing Brief at 46.

<sup>288</sup> Case No. 2020-00290, *Electronic Application of Bluegrass Water Utility Operating Company, LLC for an Adjustment of Rates and Approval of Construction* (Ky. PSC Aug. 2, 2021), final Order at 13.

Scott County disagrees with Bluegrass Water's proposed unified rate and recommends a phased-in approach to the Delaplain customers only in order to prevent rate shock based on the principals of gradualism.<sup>289</sup> In its post hearing brief, Scott County states that the rates proposed by Bluegrass Water would violate these principals and does not represent fair, just and reasonable rates.<sup>290</sup>

While the Attorney General did not provide expert witness testimony nor any evidence to support its position, it did request that such a large rate increase be phased in gradually to minimize rate shock based on the principals of gradualism.<sup>291</sup> In its post hearing brief, the Attorney General states the Commission should consider whether a phased-in approach is better for those systems that are not currently a part of Bluegrass Water's current consolidated rates as they are more likely to experience larger increases than those systems that are a part of the unified rate.<sup>292</sup> The Attorney General further states that while they did not make a formal recommendation, or provide expert witness testimony or support of a phased-in rate, this silence does not indicate opposition to such an approach.<sup>293</sup>

Bluegrass Water argues that eventually each of the systems will require significant capital investment; therefore, the customers are better served by the proposed unified rate.<sup>294</sup> Bluegrass Water states the Attorney General's own expert testified in his direct

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<sup>289</sup> Scott County's Post-Hearing Brief at 21.

<sup>290</sup> Scott County's Post-Hearing Brief at 17.

<sup>291</sup> Attorney General's Post-Hearing Brief at 5.

<sup>292</sup> Attorney General's Post-Hearing Brief at 4.

<sup>293</sup> Attorney General's Post-Hearing Brief at 5.

<sup>294</sup> Cox Direct Testimony at 13.

testimony that the proposed unified rate “will allow for the financial burdens common to all systems to be distributed in a beneficial manner to each of the ratepayers, and allow the systems—which are historically distressed—to be brought into and kept in compliance and to continue providing safe and reliable service.”<sup>295</sup> Bluegrass Water states that the Commission has consistently supported a unified rate structure to encourage consolidation of systems to improve the quality of service in the Commonwealth.<sup>296</sup>

The Commission supports the principle that utility rates should be cost based, and that in most circumstances each class of utility ratepayers should pay the costs which the utility incurs to provide that class with utility service. The majority of Bluegrass Water’s customers are in the residential class. A separate rate for each geographically distinct merged system of Bluegrass Water would create unreasonable and undue hardship to individuals in some areas served by Bluegrass Water. The Commission finds that the proposed unified rate, with wastewater multi-family dwellings and commercial customers monthly rates based on residential equivalency, should be approved for Bluegrass Water’s customers.

Utilizing the Commission’s required revenue requirement of \$2,905,451, the monthly residential unified rates will decrease from the current \$85.97 to \$77.77, or (9.5) percent. For the five Bluegrass Water systems being integrated into unified rates, the change in rates is listed below:

- Darlington Creek: \$45.00 current fixed charge to \$77.77 fixed charge, a 72.82 percent increase;

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<sup>295</sup> Dittmore Direct Testimony at 33.

<sup>296</sup> Bluegrass Water’s Post-Hearing Brief at 47.

- Delaplain: \$12.50 fixed charge to \$77.77 fixed charge, a 522.16 percent increase;
- Herrington Haven: \$49.66 fixed charge to \$77.77 fixed charge, a 56.60 percent increase;
- Springcrest: \$27.43 fixed charge to \$77.77 fixed charge, a 183.52 percent increase; and
- Woodland Acres: \$19.47 fixed charge to \$77.77 fixed charge, a 299.44 percent increase.<sup>4</sup>

In addition to residential rates, the change in Bluegrass Water's Multifamily unit rate would decrease from a fixed charge of \$64.48 to \$58.33, or a (9.54) decrease. For the Delaplain system commercial rate, the new fixed monthly charge would be \$194.43 and the per 1,000 gallon monthly charge would increase from \$8.89 to \$11.67. Based on average customer usage, this would result in a 49.2 percent increase. Finally, the Persimmon Ridge system fixed non-residential rate would decrease from \$214.93 to \$194.43, or (9.54) percent

#### Nonrecurring Charges

In its application, Bluegrass Water proposes to assess both a Returned Check Charge of \$15.00 and a Late Payment Penalty of 10 percent.<sup>297</sup> The Commission has reviewed Bluegrass Water's current and proposed Nonrecurring Charges for its sewer operations. Bluegrass Water has provided cost justification supporting the proposed Returned Check Charge of \$15.00.<sup>298</sup> In support of this charge, Bluegrass Water states

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<sup>297</sup> Thies Direct Testimony at 36.

<sup>298</sup> Bluegrass Water's Response to Staff's Fourth Request, Item 23.

that the new Nonrecurring Charges are to recover costs incurred by Bluegrass Water. In support of its Late Payment Penalty, Bluegrass Water states that other similar utilities throughout Kentucky have been authorized a late payment penalty for water and wastewater service. Both Mountain Water District and Letcher County Water and Sewer District have been authorized to assess a 10 percent late payment penalty. Additionally, several wastewater utilities acquired by Bluegrass Water since its last rate case were authorize a 10 percent late payment penalty and is proposing to charge this penalty to all of its service areas.<sup>299</sup>

The Attorney General states that Bluegrass Water should only be authorized to charge a 10 percent late payment penalty on services that are 30 days or more past due, and recommends the Commission clarify in its final Order that Bluegrass Water should only assess this penalty on bills 30 days or more past due.<sup>300</sup>

The Commission accepts Bluegrass Water's proposed 10 percent late payment penalty but also agrees with the Attorney General that it shall only be assessed once for service that is 30 days or more past due. Kentucky regulation 807 KAR 5:006, Section 9 (3)(h)(1) states that "the late payment charge may be assessed only once on a bill for rendered services."

#### Effective Date and Refund

On November 1, 2023, Bluegrass Water made a filing in which it provided the Commission notice pursuant to KRS 278.190(2) of its intent to place proposed rates into effect, subject to refund, on or after December 1, 2023. However, the rates determined

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<sup>299</sup> Thies Direct Testimony at 37.

<sup>300</sup> Dittmore Direct Testimony at 10.

to be reasonable and approved herein are different and lower than those proposed by Bluegrass Water in its application. Thus, the Commission finds that the rates approved herein should be effective for service rendered on or after December 1, 2023, and that Bluegrass Water should refund to its customers all amounts collected in excess of the rates approved herein for service rendered on or after December 1, 2023, through the date of entry of this Order.

### SUMMARY

The Commission, after consideration of the evidence of record and being otherwise sufficiently advised, finds that:

1. The rates set forth in Appendix B to this Order are the fair, just and reasonable rates for Bluegrass Water to charge for service rendered on and after the date of this Order.

2. The rate of return granted herein is fair, just and reasonable and will provide sufficient revenue for Bluegrass Water to meet its financial obligations with a reasonable amount remaining for equity growth.

3. The rates proposed by Bluegrass Water would produce revenue in excess of that found reasonable herein and should be denied.

IT IS THEREFORE ORDERED that:

1. The rates and charges proposed by Bluegrass Water are denied.
2. The rates in Appendix B to this Order are approved for service rendered by Bluegrass Water on and after December 1, 2023, for the systems at issue in this matter.

3. Within 20 days of the date of this Order, Bluegrass Water shall file with the Commission, using the Commission's Electronic Tariff Filing System, new tariff sheets setting forth the rates, charges, and revisions approved herein.

4. Within 60 days of the date of service of this Order, Bluegrass Water shall refund to each customer all amounts collected from that customer in excess of the rates approved in this Order for service rendered on or after December 1, 2023, through the date of entry of this Order.

5. Bluegrass Water should track all late fees and record them as a regulatory asset or liability to the extent that they exceed the \$14,244 in late fee revenue Bluegrass Water included in the test period. Within 60 days after the 12-month period following the effective date of the rates approved in this case, Bluegrass Water shall report to the Commission the monthly amount of late fees invoiced (less any refund required by this order), the monthly number of occurrences of late fees, and the monthly total number of Bluegrass Water customers for the 12-month period, and shall propose a method for timely distribution of the accumulated amount to its customers.

6. Absent a request for rehearing, this case will be closed and removed from the Commission's docket upon expiration of the statutory time period to request rehearing.

PUBLIC SERVICE COMMISSION

  
Chairman

  
Vice Chairman

  
Commissioner

ENTERED  
FEB 14 2024 rcs  
KENTUCKY PUBLIC  
SERVICE COMMISSION

ATTEST:

  
Executive Director

## APPENDIX A

### APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2022-00432 DATED FEB 14 2024

NARUC Account	Account Description	Test Year Ended 44742	Known and Measurable Adjustments	Known & Measurable Adjustments	Known & Measurable Adjustments	Pro Forma at Present Rates
<b>Revenues</b>						
521.000	Revenues- Sewer	\$1,923,537	\$ 76,736	\$ (15,347) (52,664)	\$ 61,389 (52,664)	\$ 1,932,262
522.000	Revenues- Sewer	420,860	-			420,860
532.000	Revenues- Sewer	14,244	-			14,244
536.000	Revenues- Sewer	217				217
	<b>Sewer Revenues</b>	<b>2,358,858</b>	<b>76,736</b>	<b>(68,011)</b>	<b>8,725</b>	<b>2,367,583</b>
<b>Expenses</b>						
<b>G&amp;A- General &amp; Admin:</b>						
408.100	Taxes	22,046	(19,399)	(480)	(19,879)	
			\$480	(120)	360	2,527
408.160	Property Tax	11,792	15,945	35	15,980	27,772
409.000	Income Taxes	157				157
903.100	Billing Expense	75,762	3,167	(792)	2,375	78,137
903.280	Billing Expense- Bank Fees	10,625	582	(146)	437	11,061
904.000	Bad Debt Expense	32,027	1,355	(30,853)	(29,498)	2,529
922.000	Allocated Overhead	445,726	(34,201)	-	(34,201)	
				15,997	15,997	
				(4,312)	(4,312)	423,210
923.100	OSS- Bank Fees Outside Services	324	24	(6)	18	342
923.400	OSS- Legal	51,679	991	(248)	743	52,422
923.500	OSS- Accounting	10,584	456	(114)	342	10,926
923.600	OSS- Management Consulting	13,636	489	(122)	367	14,003
923.900	OSS- IT	30,122	(10,555)	(1,479)	(12,035)	
			96	(24)	72	18,159
924.400	Property Insurance	224,091	745	(90,156)	(89,411)	
				(12,260)	(12,260)	122,420
928.100	Direct Admin DNR	(15,934)	-	-	-	(15,934)
930.200	Misc. General Expense	1,258	-	-	-	1,258
	<b>Total Sewer G&amp;A - General &amp; Admin</b>	<b>913,893</b>	<b>(39,824)</b>	<b>(125,080)</b>	<b>(164,904)</b>	<b>748,989</b>
<b>Ops &amp; Maint - Operations &amp; Maintenance:</b>						
701.000	Sewer- Contract Operations Labor & Expense	981,339	106,196	(18,028)	88,168	
				(196,350)	(196,350)	
				(19,705)	(19,705)	
				23,728	23,728	
				(41,002)	(41,002)	836,178
702.000	Sewer- Misc. Operations	2,000	-			2,000
703.000	Sewer- Electric Utilities	179,314	4,316	(1,079)	3,237	182,551
704.000	Sewer- Chemicals	103,966	-			103,966
705.000	Sewer- Misc. Operations	76,275	108,473	(27,118)	81,355	157,630
711.000	Sewer- Mowing & Grounds Maintenance	95,129	3,472	(868)	2,604	97,733
712.000	Sewer- Maintenance of Collection Systems	39,630	-			39,630
713.000	Sewer- Maintenance Services to Customers	4,069	-			4,069
713.001	Sewer- Maintenance of Pumping System	49,036	-			49,036
714.000	Sewer- Maintenance of Treatment & Disposal Equipment	18,635	-			18,635
715.000	Sewer- Maintenance of Other Plant Facilities	13,471	-			13,471
722.000	Sewer- Sludge Hauling	43,265	-			43,265
732.000	Sewer - Maintenance	233	-			233
741.000	Sewer- Chemicals	3,313	-			3,313
752.000	Sewer- Maintenance	152	-			152
	<b>Total Sewer Ops &amp; Maint - Operations &amp; Maintenance</b>	<b>1,609,826</b>	<b>222,457</b>	<b>(280,422)</b>	<b>(57,965)</b>	<b>1,551,861</b>
<b>Interest</b>						
427.000	Interest	-	168,717	(25,938)	142,778	142,778
	<b>Total Interest Expense</b>	<b>-</b>	<b>168,717</b>	<b>(25,938)</b>	<b>142,778</b>	<b>142,778</b>
<b>Depr &amp; Amort - Depreciation &amp; Amortization</b>						
403.000	Depreciation	187,171	11,043	(1,193)	9,850	
				(21,490)	(21,490)	
				(26,222)	(26,222)	
				(5,523)	(5,523)	
				(2,440)	(2,440)	152,390
403.100	CIAC Amort	(24,960)	-	-	-	(24,960)
405.000	Rate Case Amort	-	59,853	-	59,853	59,853
	<b>Total Depr &amp; Amor - Depreciation &amp; Amortization</b>	<b>162,212</b>	<b>70,896</b>	<b>(56,868)</b>	<b>14,028</b>	<b>187,283</b>
	<b>Total Sewer Expenses</b>	<b>2,685,931</b>	<b>422,245</b>	<b>(488,308)</b>	<b>(66,062)</b>	<b>2,630,912</b>
	<b>Income</b>	<b>\$ (327,073)</b>	<b>\$ (345,509)</b>	<b>\$ 420,296</b>	<b>\$ 74,787</b>	<b>\$ (263,329)</b>

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 2022-00432 DATED FEB 14 2024

Sewer Rates

All Systems Except Magruder Village, Yung Farm Estates, Moon River, and  
Commonwealth Water

Residential	\$77.77 Per Month per unit
Multi-Family	58.33 Per Month per unit
Non-residential/Commercial	197.43 Per Month per unit
Commercial Usage Charge	11.67 Per 1,000 Gallons

Nonrecurring Charges

Tap-On Fee	Actual Cost
Returned Check Charge	\$15.00
Late Payment Penalty	10 percent

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