

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC MARTIN COUNTY WATER)	CASE NO.
DISTRICT MANAGEMENT AND OPERATION)	2020-00154
MONITORING PURSUANT TO KRS 278.250)	

ORDER

The Commission, on its own motion, establishes this proceeding pursuant to KRS 278.250 to monitor Martin County Water District’s (Martin District) managerial, financial, and operational position and its continued cooperation with and improvement under the management of Alliance Water Resources, Inc. (Alliance).

Pursuant to KRS 278.250, the Commission may investigate and examine the condition of any utility subject to its jurisdiction whenever it is necessary in the performance of the Commission’s duties. Over 20 years, Martin District has failed to resolve financial and operational mismanagement despite multiple investigations by the Commission with specific action plans for improvement that Martin District never implemented.¹ Due to Martin District’s failure to cure ongoing mismanagement, the Commission ordered Martin District to enter into a management contract with Alliance, a national provider of water and wastewater contract operation services.

¹ See Case No. 2002-00116, *Investigation of the Operating Capacity of Martin County Water District Pursuant to KRS 278.280* (Ky. PSC Nov. 17, 2003); Case No. 2006-00303, *An Investigation into the Management and Operation of Martin County Water District* (Ky. PSC June 26, 2006); Case No. 2016-00142, *Electronic Investigation of the Operating Capacity of Martin County Water District Pursuant to KRS 278.280* (Apr. 11, 2016); and Case No. 2018-00017, *Electronic Application of Martin County Water District for an Alternative Rate Adjustment* (Ky. PSC Nov. 15, 2019) Order at 7–10 (November 15, 2019 Order).

Since January 1, 2020, Alliance has provided management, operation, and maintenance services for Martin District. Over the past four months, Alliance hired a general manager and an operations manager for day-to-day oversight; developed controls, policies, and procedures for financial and administrative practices; implemented improved meter reading and billing processes; and filed with the Commission an infrastructure replacement plan to address Martin District's aging infrastructure.

A brief discussion of events over the past two years highlights the need for the Commission to continue monitoring Martin District's financial and operational condition due to the history of Martin District's board failing to strictly comply with Commission Orders. In the Commission's fourth investigation of the utility, Martin District's board failed to comply with a Commission Order to replace a part-time interim manager with a full-time, permanent, experienced general manager. Martin District conducted a six-month search process and identified three well-qualified candidates, but failed to offer the position to any of the well-qualified candidates, asserting contradictory reasons for its failure to comply with the Commission's Order.² Subsequently, the Commission ordered Martin District to enter into a contract with a third-party manager.³ The Commission reasoned that an experienced third-party manager was necessary to return Martin District to solid financial and managerial footing given the almost 20 years that Martin District failed to act on its own or to implement action steps ordered by the Commission. Martin District solicited bids, eventually selecting Alliance. However, while negotiating with

² Case No. 2016-00142, August 29, 2018 Hearing Video Transcript (HVT) at 1:41:38, 1:42:33, and 1:47:58.

³ Case No. 2018-00017 (Ky. PSC Nov. 5, 2018), Order at 6.

Alliance, Martin District requested to change course and hire a general manager instead, making unsupported assertions that hiring a general manager would cost less than contracting with Alliance.⁴ The Commission denied Martin District's request.⁵ Despite the legal requirement to conduct annual financial audits, Martin District did not complete its 2016 financial audit until December 2019 because its board members failed to ensure that the auditors had the required financial information.⁶

Of particular consequence for Martin District ratepayers, the Commission is now aware that the Martin District Board acquiesced⁷ to interest rates paid to Evans Hardware and CI Thornburg Co., Inc. (CI Thornburg) that allegedly violate usury laws by charging an interest rate that is substantially higher than the 8 percent legal interest rate established by Kentucky's interest and usury law, KRS 360.010.⁸ A threshold issue is whether KRS 360.010 applies to the interest charged to Martin District by Evans Hardware and CI Thornburg. Kentucky courts define interest as compensation allowed by law "for the loss of money by one who is entitled to its use."⁹ Courts look beyond the label applied to the charge and examine the substance of a transaction when evaluating

⁴ Case No. 2018-00017, Motion to Hire a General Manager (filed Oct. 31, 2019).

⁵ *Id.* at Nov. 15, 2019 Order at 31–35.

⁶ *Id.* at 12–14.

⁷ June 16, 2020 HVT at 13:13:30. Martin District Board Chair Kerr testified he was aware of the interest rate charged by Evans Hardware and that there was a discussion of Evans Hardware waiving a portion of the bill and interest once the unpaid balance was paid.

⁸ KRS 360.010 establishes a legal interest rate of 8 percent, but permits parties to agree in writing to a higher interest rate that is capped at the lesser of 19 percent or 4 percent over the federal discount rate on 90-day commercial paper. Further, Kentucky laws permit higher interest rates on written agreements for credit cards and consumer loans.

⁹ *Grace v. LVNV Funding, Inc.*, 22 F.Supp.3d 700, 704 (W.D. Ky. 2014). See also *Brown v. Hiatts*, 82 U.S. 177, 185 (1872).

whether a charge is “disguised interest.”¹⁰ Under facts similar to those presented here, courts have held that a penalty or delinquency charge assessed by a vendor for an amount past due on goods purchased by or service provided to a debtor falls within the ordinary legal meaning of “interest” because it is a form of compensation for the vendor’s loss of money that vendor is entitled to the use, and thus KRS 360.010 governs.¹¹

Although not binding law, the Attorney General of the Commonwealth of Kentucky (Attorney General) issued an opinion based on similar reasoning that the substance of the transaction and not a label is determinative of whether KRS 360.010 applies to a transaction. The Attorney General found that KRS 360.010 applies to accounts remaining unpaid after their due date regardless of how a charge is styled, absent the applicability of other statutes establishing interest rates, such as laws pertaining to interest on judgments, credit cards, or consumer loans.¹²

Based on settled law discussed above, the Commission finds that interest on the unpaid amounts due to Evans Hardware and CI Thornburg for goods purchased by and services provided to Martin District is governed by KRS 360.010.

Martin District stated that it does not have a written agreement, contract, promissory note, or obligation with Evans Hardware regarding the amounts due for past

¹⁰ *Grace*, 22 F.Supp.3d at 703-704; *Hurt v. Crystal Ice & Cold Storage Co.*, 286 S.W. 1055, 1056-1056 (Ky. 1926).

¹¹ *Grace*, 22 F.Supp.3d at 703-705.

¹² OAG 70-800. See also OAG 72-598 (finding that KRS 360.010 applies to the legal interest rate that a county hospital could charge interest on delinquent accounts).

purchases.¹³ According to Evans Hardware's invoices and Martin District, Evans Hardware charges simple interest at a rate of 18 percent per annum for unpaid invoices.¹⁴ As of June 30, 2020, on one of its two accounts, Martin District owed Evans Hardware \$30,200.99 for purchases made between 2015 and 2017, and \$25,789.80 in interest charged between 2016 and 2020 for those purchases, for a total due of \$55,990.79.¹⁵ Based upon the finance charges on this account, it appears that Evans Hardware has charged Martin District approximately 20 percent simple interest on this account, but the actual amount is not readily determinable because payments made by Martin District were not included on account statements. Also, as of June 30, 2020, Martin District owed Evans Hardware on a second account \$18,820.64 for purchases made between 2018 and 2019, and \$3,326.32 in interest charged between 2018 and 2020, for a total of \$22,146.96.¹⁶

Martin District filed written agreements with CI Thornburg to repay amounts due on three unpaid accounts, but the agreements do not set forth an interest rate. According to Martin District, CI Thornburg charged simple interest at a rate of 18 percent per annum between September 2018 and May 2020 on two of the accounts, which resulted in finance

¹³ Martin District's Response to Commission Staff's Post-Case Request for Information (Staff's Post-Case Request), Item 3; June 16, 2020 HVT at 13:13:22.

¹⁴ Evans Hardware Response to *Subpoena Duces Tecum* (filed July 8, 2020); Martin District's Response to Staff's Post-Case Request, Item 3.

¹⁵ The purchases were made between August 4, 2015, and March 14, 2016, and between December 22, 2016, and March 29, 2017. The interest charges accrued between May 31, 2016, and June 30, 2020.

¹⁶ The purchases were made between May 8, 2018, and December 31, 2018, and November 4, 2019, and December 30, 2019. The interest charges accrued between August 31, 2018, and June 30, 2020.

charges of \$2,997.55 and \$4,403.04 respectively.¹⁷ Because the written agreement provided by Martin District does not set forth an interest rate, the provision in KRS 360.010 for higher interest rates charged on written agreements is not applicable. Even if the provision were applicable, the permissible interest rate established in KRS 360.010 for written agreements is the lesser of 19 percent or 4 percent over the federal discount rate for 90-day commercial paper. Given that the federal discount rate for 90-day commercial paper fluctuated between 2.30 percent in September 2018 and 0.18 percent in July 2020, with a high of 2.56 percent in January 2019, the effective maximum annual interest rate permitted by KRS 360.010 would be 8 percent because the applicable federal discount rate plus 4 percent would be less than 8 percent.¹⁸

KRS 360.020, which sets forth the penalty for charging excessive interest, states:

The taking, receiving, reserving, or charging a rate of interest greater than is allowed by KRS 360.010, when knowingly done, shall be deemed a forfeiture of the entire interest which the note, bill, or other evidence of debt carries with it, or which has been agreed to be paid thereon. In case the greater rate of interest has been paid, the person by whom it has been paid, or his legal representatives, may recover, in an action in the nature of an action of debt, twice the amount of the interest thus paid from the creditors taking or receiving the same: provided, that such action is commenced within two (2) years from the time the usurious transaction occurred.

As the Commissioners stated at a recent hearing in Case No. 2018-00017, had the Commission been informed of the interest rates that exceeded the legal limit, it would

¹⁷ Martin District's Response to Staff's Post-Case Request, Item 4.

¹⁸ Federal Reserve Bank of St. Louis, Economic Research, 90-Day AA Nonfinancial Commercial Paper Interest Rate, September 2018-July 2020, available at: <https://fred.stlouisfed.org/series/RIFSPNAAD90NB>.

never have approved the priority of payment with Evans Hardware and CI Thornburg being paid last, along with ZipZone and Martin District's former bookkeeper–accountant.¹⁹

Based on the above, the Commission finds that Martin District Board should take immediate steps to address the excess interest charged by and paid to Evans Hardware and CI Thornburg, up to and including seeking remedies available to Martin District pursuant to KRS 360.020. Pursuant to KRS 74.070(2), the business and affairs of Martin District are managed under the direction and oversight of its Commissioners. Further, each Martin District Commissioner has a fiduciary duty to Martin District ratepayers to act in the best interest of the ratepayers. Given the dire financial position of Martin District, the Commissioners have not acted in ratepayers' best interests by agreeing to and paying excess interest.

Additionally, given the excessive interest rate charged by Evans Hardware and Martin District's ability to buy supplies from other sources, the Commission finds that Martin District should file a monthly report no later than the 15th of every month listing all purchases made from Evans Hardware, the justification for the purchase, and an explanation why it could not be obtained from another source or why the supply was not kept in inventory.

Based upon the foregoing, the Commission finds that this proceeding should be established to monitor the financial and operational condition of Martin District and Martin District's cooperation with and improvement under Alliance. The Commission further finds that Martin District and Alliance should file periodic reports in this case that permit the Commission to monitor the operation and management of Martin District. For reasons

¹⁹ June 16, 2020 HVT at 13:12:10. The Commission notes that, according to Martin District, neither ZipZone nor the former bookkeeper–accountant is charging interest on the unpaid balances.

of administrative efficiency, the Commission finds that required periodic reports established in ordering paragraphs 6, 7, and 11 in Case No. 2018-00017 should now be filed in this proceeding instead of Case No. 2018-00017. Additionally, a monthly informal conference should be scheduled for Commission Staff to discuss the monthly board packets with Alliance personnel. The Commission also finds that the case records of Case Nos. 2016-00142 and 2018-00017 should be incorporated by record into this proceeding. Finally, the Commission finds that Martin County Concerned Citizens, who was an intervening party in Case Nos. 2016-00142 and 2018-00017, should be made a party to this proceeding.

IT IS THEREFORE ORDERED that:

1. This case is opened to monitor Martin District's financial and operational condition and Martin District's cooperation with and improvement under Alliance.
2. The records of Case No. 2016-00142 and 2018-00017 are incorporated by reference into Case No. 2020-00154.
3. Martin County Concerned Citizens is a party to this proceeding and shall be served with a copy of this Order.
4. Martin County Concerned Citizens shall comply with all provisions of the Commission's regulation 807 KAR 5:001, Section 8, related to the service and electronic filing of documents.
5. Pursuant to 807 KAR 5:001, Section 8(9), within seven days of entry of this Order, Martin County Concerned Citizens shall file a written statement with the Commission that:

a. Certifies that it, or its agent, possesses the facilities to receive electronic transmissions; and

b. Sets forth the electronic mail address to which all electronic notices and messages related to this proceeding should be served.

6. On a quarterly basis, beginning October 15, 2020, Martin District shall file the following reports with the Commission:

a. Quarterly activity reports that include a statement of quarterly Debt Service Surcharge billing and collections; the monthly surcharge bank statements for that quarter; a list of each payment from the account, its payee, and a description of the purpose; and a schedule of amounts due on the past due debts for each vendor receiving payment from the Debt Service Surcharge.

b. Quarterly report updating the status of Martin District's Infrastructure Replacement Plan.

7. On a monthly basis, a copy of the information packet prepared by Alliance for the Martin District monthly board meetings shall be filed into the case record on the same date the board packet is provided to Martin District Commissioners.

8. A monthly informal conference shall be scheduled for the purpose of discussing the information contained in the board packet. Commission Staff will timely issue a notice of informal conference.

9. Martin District shall file a monthly report no later than the 15th of every month listing all purchases made from Evans Hardware the previous month with a narrative justification for the purchase, and explanation why it could not be obtained from another source or why the supply was not kept in inventory.

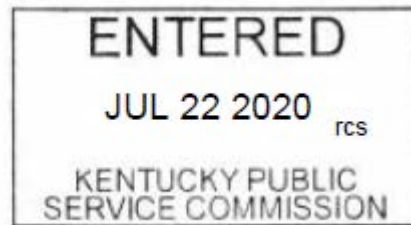
10. Martin District Board shall take immediate steps to halt the excess interest charged by and paid to Evans Hardware and CI Thornburg, up to and including seeking remedies available to Martin District pursuant to KRS 360.020. Within 20 days of the date of this Order, Martin District Board shall file a report outlining its actions taken to remedy the excess interest charged by and paid to Evans Hardware and CI Thornburg and the recalculated amounts due to both vendors.

11. On or before January 1, 2021, Martin District, under Alliance's guidance, should evaluate whether a rate decrease or increase is necessary. Within ten days of completing the evaluation or March 1, 2021, whichever occurs first, Martin District, with the assistance of Alliance, should file a report in this proceeding that provides specific information regarding the evaluation and determination.

12. If Martin District breaches the management contract, Alliance shall file notice with the Commission within ten days of the breach.

13. If Alliance breaches the management contract, Martin District shall file notice with the Commission within ten days of the breach.

By the Commission



ATTEST:



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