

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF THE CITY OF IRVINE)	
UTILITY COMMISSION TO ACQUIRE THE)	CASE NO.
FACILITIES OF THE ESTILL COUNTY WATER)	2014-00425
DISTRICT NO. 1)	

ORDER

On December 4, 2014, the City of Irvine Utility Commission (“Irvine Utility Commission”)¹ and the Estill County Water District No. 1 (“Estill No. 1”) filed a Joint Application requesting Commission approval of the transfer of ownership and control of Estill No. 1’s wastewater facilities and services to Irvine Utility Commission.² The request will allow Estill No. 1 to discontinue its provision of wastewater services.

Estill No. 1 is a water district organized pursuant to KRS Chapter 74. It owns, controls, operates, and manages facilities in the Commonwealth of Kentucky which are used for and in connection with the distribution and furnishing of water to the public for

¹ The Joint Application uses “City of Irvine Utility Commission (‘IMU’)” as the name of this petitioner and describes this petitioner as a department of the city of Irvine, Kentucky. “IMU” is an abbreviation for Irvine Municipal Utilities which is described as “an enterprise fund of the City of Irvine, Kentucky.” See Joint Application, Exhibit D, *Irvine Municipal Utilities, City of Irvine, Audited Financial Statements, June 30, 2013* (“2013 Irvine Audited Financial Statements”) at 8; See also Joint Application, Exhibit G, December 16, 2005 letter from Shafiq S. Amawi, Manager, Kentucky Division of Water Facilities Construction Branch, to Bee Williams, Manager, Irvine Municipal Utilities.

² The Chairmen of Estill No. 1 and Irvine Utility Commission each signed the Joint Application on behalf of their respective entities. The Commission notes that the Mayor of the city of Irvine and the County Judge/Executive of Estill County also signed the Joint Application in their official capacities. No person has requested intervention in this matter.

compensation, and other facilities which are used for and in connection with the collection, transmission, or treatment of sewage for the public for compensation.³

Estill No. 1's sewage facilities and operations serve approximately 472 customers in Estill County, Kentucky,⁴ and its service territory generates, on average, approximately 125,000 gallons of sewage per day.⁵ As of December 31, 2012, Estill No. 1 had utility plant of \$4,546,488 and accumulated depreciation of \$2,075,974, or a net utility plant of \$2,470,514.⁶ As of December 31, 2012, Estill No. 1 had total liabilities and other credits of \$2,756,669, which includes a negative unappropriated retained earnings amount of \$1,297,680.⁷ For the calendar year ending December 31, 2012, Estill No. 1 had utility operating revenues of \$170,791 and utility operating expenses of \$329,009, which result in a negative net operating income of \$158,218.⁸ Estill No. 1 holds deposits collected from its wastewater customers.⁹

Irvine Utility Commission is a municipal utility that owns, controls, operates, and manages facilities in the Commonwealth of Kentucky which are used for and in connection with the distribution and furnishing of water to the public for compensation,

³ Estill No. 1 files separate annual reports to the Public Service Commission for its water operations and sewer operations. Unless otherwise noted, all references are to Estill No. 1's sewer operations.

⁴ *Annual Report of Estill County Water District No. 1 – Sewer Division to the Public Service Commission for the Calendar Year Ended December 31, 2012* ("2012 Annual Report") at 38.

⁵ Joint Application, Exhibit J, Affidavit of Billy F. Williams, II.

⁶ 2012 Annual Report at 16.

⁷ *Id.* at 14-15.

⁸ *Id.* at 27-28.

⁹ Response to Commission Staff's First Request for Information ("Staff's First Request"), Item 3.

and other facilities which are used for and in connection with the collection, transmission, or treatment of sewage for the public for compensation. Irvine Utility Commission's sewage facilities have a treatment capacity of two million gallons a day,¹⁰ and its service territory generates, on average, approximately 608,000 gallons of sewage per day.¹¹ For the fiscal year ended June 30, 2013, Irvine Utility Commission reported total assets of \$19,582,529, total liabilities \$6,539,269, and total net assets of \$13,043,260.¹² For the same period, Irvine Utility Commission reported total operating revenue of \$1,884,767 and total operating expenses of \$2,012,169, which result in a negative net operating income of \$65,791.¹³ For the same period, Irvine Utility Commission reported an increase in net assets of \$252,034.¹⁴

In 2005, Estill No. 1's wastewater treatment plant was operating over its rated capacity and was under an Agreed Order with the Kentucky Division of Water for failing to meeting Kentucky Pollution Discharge Elimination System ("KPDES") pollutant limits.¹⁵ At that time, the Irvine Utility Commission's wastewater treatment plant was also operating over its rated capacity; however, it was in compliance with KPDES pollutant limits.¹⁶ Rather than replacing or expanding both the Estill No. 1 wastewater

¹⁰ Joint Application, Exhibit J, Affidavit of Billy F. Williams, II.

¹¹ *Id.*

¹² *Id.*, Exhibit D, *2013 Irvine Audited Financial Statements*, at 5.

¹³ *Id.* at 6.

¹⁴ *Id.*

¹⁵ *Id.*, Exhibit G, *Irvine Municipal Utilities, Irvine, Kentucky Regional Facilities Plan, Draft: December 2004; Final: September 2005.*

¹⁶ *Id.*

treatment plant and the Irvine Utility Commission wastewater treatment plant, local city and county leaders agreed to expand the Irvine Utility Commission wastewater plant so that it would have enough capacity to treat its customers' wastewater and the wastewater from the Estill No. 1 system.¹⁷ In August 2009, Estill No. 1 and the city of Irvine ("City") entered into a "Sewer Contract" concerning the construction and use of the new Irvine Utility Commission wastewater treatment plant.¹⁸

On January 29, 2014, the Kentucky Division of Water denied a Kentucky Pollution Discharge Elimination System ("KPDES") permit to Estill No. 1.¹⁹ The Kentucky Energy and Environment Cabinet ("EEC") has an enforcement action against Estill No. 1 that is pending.²⁰ The EEC has placed its enforcement action on hold, but has conditioned the hold on Estill No. 1's strict compliance with the EEC's requirements that include an approved closure plan for and proper decommissioning of Estill No. 1's wastewater treatment plant.²¹ The EEC states that if Estill No. 1 complies with the EEC's requirements, then no penalty will be sought and the enforcement case against Estill No. 1 will be dismissed.²²

On September 15, 2014, Estill No. 1, Estill County, Kentucky, through its Fiscal Court ("County"), the City, and Irvine Utility Commission entered into a Memorandum

¹⁷ *Id.*

¹⁸ *Id.*, Exhibit A, Memorandum Settlement Agreement, at 2.

¹⁹ *Id.*, Exhibit E, Jan. 29, 2014 letter from Peter T. Goodman, Acting Director, Kentucky Division of Water to Dwight Richardson.

²⁰ Response to Staff's First Request, Item 7 and the attachment, Oct. 17, 2014 letter from Anna K. Girard, attorney, Energy and Environment Cabinet, to Larry R. Anderson.

²¹ *Id.*

²² *Id.*

Settlement Agreement (“Agreement”).²³ The Agreement states that “the City and County have adopted a 2005 Regional Facilities Plan, approved by the Commonwealth of Kentucky, Division of Water, in which the City and the County agree to the joint resolution of their respective inadequate wastewater treatment facilities operating, at that time, beyond capacity and in violation of various State and Federal parameters....”²⁴

The Agreement states that “subsequent to the date of adoption of the 2005 Regional Facilities Plan (the ‘Plan’), the District [Estill No. 1], the County, the City and IMU [Irvine Utility Commission], on June 6, 2007, executed a certain Memorandum of Agreement whereby the parties agreed to pursue construction of a new City wastewater treatment facility to be owned and operated by the City and IMU and to which the District’s wastewater flow would be diverted through the District’s collection system and new pump stations.”²⁵

The Agreement states that Estill No. 1 and the City entered into a “Sewer Contract” and that disputes arose between Estill No. 1 and the City and Irvine Utility Commission “concerning the fees to be paid by the District to IMU for use of the new wastewater treatment plant and the District’s ultimate responsibility to divert its wastewater to the new facility” after the new wastewater facility commenced operation.²⁶

²³ Joint Application, Exhibit A, Memorandum Settlement Agreement.

²⁴ *Id.* at 1.

²⁵ *Id.* at 1.

²⁶ *Id.* at 2.

The Agreement states that “in order to resolve the dispute, the City of Irvine has instituted litigation in the Estill Circuit Court, being Civil Action Number 14-CI-21, styled The City of Irvine Utility Commission v. Estill County Water District No. 1.”²⁷ Pursuant to the terms of the Agreement, Estill No. 1 is to transfer its wastewater operations including certain property, facilities, customers, records, and rights to Irvine Utility Commission.²⁸

Pursuant to the Agreement, Irvine Utility Commission “shall assume, agree to pay, pay, and indemnify and hold the District harmless from the outstanding balance remaining from the District to the USDA” of approximately \$307,000.²⁹ Upon completion of the transfer, Irvine Utility Commission will provide wastewater treatment service to all current customers of Estill No. 1 and will have the “sole responsibility and liability for any fines, penalties, assessments, and liabilities arising out of its use and operation” of the wastewater facilities it acquires pursuant to the Agreement.³⁰ Estill No. 1 will also decommission its wastewater treatment plant and neither the City nor Irvine Utility Commission will have any liability or responsibility for the costs of decommissioning the facility.³¹

²⁷ *Id.*

²⁸ *Id.* at 2-3. The transfer expressly excludes the real property of Estill No. 1, such as Estill No. 1's wastewater treatment plant, and also states that the transfer does not affect or alter Estill No. 1's ownership or operation of its drinking water system.

²⁹ *Id.* at 4.

³⁰ *Id.* at 4-5.

³¹ *Id.* at 4.

Irvine Utility Commission has a two-rate system with one rate applicable for service to customers inside the city limits of Irvine and Ravenna and a second rate applicable for service to customers outside the city limits of Irvine and Ravenna.³² Estill No. 1's existing customers who will be transferred to Irvine Utility Commission, and certain future customers added when the Dark Hollow and Wisemantown areas of Estill County are provided wastewater service by Irvine Utility Commission, will be charged the rate that is charged for service to customers outside the city limits of Irvine and Ravenna.³³ The Agreement states that if wastewater service is made to more remote areas of the county, the rates that will apply will not necessarily be the same as those applied to Estill No. 1's existing customers and the future customers in the Dark Hollow and Wisemantown areas of Estill County.³⁴

The Agreement includes the following provisions:

To insure that rates are fair and reasonable, IMU will conduct a cost of service study as soon as feasible. Thereafter IMU will have conducted a cost of service study every five (5) years thereafter. The cost of service study will include, but be not limited to, all the elements of cost allocations, and will be conducted in accordance with general rate setting principals [sic] of the Water Environment Federation and American Water Works Association. Future rates for City residents and for residents outside the City, will be determined based upon the cost of providing such service, as determined by these periodic cost of service studies.

The parties further agree that rates shall be adjusted annually to reflect IMU's increase in costs of operation. The annual adjustment shall be equal to the lesser of three percent (3%) or the average percentage change in the Consumer Price Index for all Urban Consumers (U.S. City

³² *Id.* at 5.

³³ *Id.* at 5. These areas will be the first priority for new wastewater treatment service.

³⁴ *Id.*

Average) published by the U.S. Department of Labor, Bureau of Labor Statistics, however the annual adjustment shall never be less than zero. Such annual rate adjustments shall be uniformly applied to all IMU customers.

The cost of having performed this periodic cost of service study shall be that of IMU. IMU shall retain such engineering firm as it deems competent to perform such study and submit the name and other relevant information concerning the firm to the County. The County shall have 14 days after receipt of written notice within which to object to the firm IMU has proposed. In the event of such an objection IMU and the County shall confer and agree on the firm to be retained to perform such cost of service study.³⁵

The Agreement is contingent upon: (1) approval of the transaction by the “Commonwealth of Kentucky, Division of Water, the Kentucky Public Service Commission, and by any other federal or state agencies having jurisdiction over the parties, to the extent such approval is required;”³⁶ (2) receiving “written assurances from such agencies of state government as are applicable that its prior activities, and those necessary for the decommissioning and closure of its existing wastewater treatment plant, shall not result in any fines, assessments, or penalties against the District;”³⁷ and (3) Estill No. 1 and/or the County receiving “such assurances as they deem necessary that no grant funds previously made available to them will be required to be [sic] repaid if this Agreement is carried out as described herein.”³⁸ Estill No. 1 has yet to obtain all of the items to remove these contingencies.³⁹

³⁵ *Id.* at 5-6.

³⁶ *Id.* at 8.

³⁷ *Id.*

³⁸ *Id.*

³⁹ Response to Staff's First Request, Items 7 and 8.

The transfer will not affect or alter Estill No. 1's ownership or operation of its water distribution facilities and service.⁴⁰ Estill No. 1 agrees that it will not build, seek to build, or operate another wastewater treatment facility that is not in conformity with the 2005 regional facilities plan.⁴¹

Having considered the record and being otherwise sufficiently advised, the Commission finds that:

1. Estill No. 1 has wastewater facilities and operations providing service to approximately 472 wastewater customers in Estill County.

2. Estill No. 1 lacks a KPDES permit to operate a wastewater treatment plant.

3. The EEC has an enforcement action pending against Estill No. 1 with regard to Estill No. 1's wastewater facilities and operations, and the EEC is seeking the closure and decommissioning of Estill No. 1's wastewater treatment plant.

4. As a result of this transaction, Estill No. 1 will close and decommission its wastewater treatment plant and will divest itself of its remaining wastewater facilities and services through transferring them to the Irvine Utility Commission.

5. The transfer of Estill No. 1 wastewater facilities and services is consistent with the *Irvine Municipal Utilities, Irvine, Kentucky, Regional Facilities Plan. Draft: December 2004; Final: September 2005*, and has been reviewed and found in conformity with the Kentucky Division of Water.

6. The city of Irvine is authorized to provide utility service including the provision of wastewater service through the Irvine Utility Commission.

⁴⁰ Joint Application, Exhibit A, Memorandum Settlement Agreement, at 3.

⁴¹ *Id.* at 4.

7. Irvine Utility Commission's rates and service are not subject to the jurisdiction of the Public Service Commission.

8. Irvine Utility Commission has four wastewater treatment operators who have been certified by the Kentucky Division of Water.⁴²

9. Irvine Utility Commission is authorized to operate a wastewater treatment plant, and the plant was designed for and has the capacity to serve the wastewater operations of the current Estill No. 1 wastewater service territory.

10. Irvine Utility Commission has agreed to provide wastewater treatment service to all current wastewater customers of Estill No. 1.

11. Irvine Utility Commission has agreed to make the extension of wastewater service to the Dark Hollow and Wisemantown areas of Estill County a priority.

12. Irvine Utility Commission has agreed to apply the same rate that it applies to its customers who live outside the city limits of Irvine and Ravenna to the customers that it acquires from Estill No. 1 and future customers added through the extension of service to the Dark Hollow and Wisemantown areas of Estill County.

13. Irvine Utility Commission has agreed to assume, pay, indemnify and hold Estill No. 1 harmless from the outstanding balance of approximately \$307,000 remaining from Estill No. 1 to the United States Department of Agriculture Rural Development ("Rural Development").

14. Irvine Utility Commission has agreed to have the sole responsibility and liability for any fines, penalties, assessments, and liabilities arising out of its use and operation of the wastewater facilities acquired from Estill No. 1.

⁴² Response to Staff's First Request, Item 10.

15. Estill No. 1 will transfer all customer deposits collected from wastewater customers to the Irvine Utility Commission.

16. Estill No. 1, the County, the City, and Irvine Utility Commission have entered into an agreement that requires rates that are established through use of periodic cost of service studies.

17. Estill No. 1, the County, the City, and Irvine Utility Commission agree to use an adjustment mechanism in order to annually adjust rates.

18. The transaction is contingent upon Estill No. 1 providing "written assurances from such agencies of state government as are applicable that its prior activities, and those necessary for the decommissioning and closure of its existing wastewater treatment plant, shall not result in any fines, assessments, or penalties against the District."⁴³

19. Estill No. 1 agrees that it will not build, seek to build, or operate another wastewater treatment facility that is not in conformity with the 2005 regional facilities plan.

CONCLUSIONS OF LAW

1. Estill No. 1 is a public utility subject to the jurisdiction of the Public Service Commission.⁴⁴

2. Irvine Utility Commission is a department of the City. The City is a "corporation" and a "person" for purposes of KRS Chapter 278.⁴⁵

⁴³ Joint Application, Exhibit A, Memorandum Settlement Agreement, at 8.

⁴⁴ KRS 278.015.

⁴⁵ KRS 278.010(1) and (2).

3. KRS 278.020(5) states that “[n]o person shall acquire or transfer ownership of, or control, or the right to control, any utility under the jurisdiction of the commission by sale of assets, transfer of stock, or otherwise, or abandon the same, without prior approval by the commission.”

4. KRS 278.020(6) states that:

No individual, group, syndicate, general or limited partnership, association, corporation, joint stock company, trust, or other entity (an "acquirer"), whether or not organized under the laws of this state, shall acquire control, either directly or indirectly, of any utility furnishing utility service in this state, without having first obtained the approval of the commission.

5. The City, through the Irvine Utility Commission, has the legal authority to provide wastewater service to the area that Estill No. 1 presently serves.

6. The transfer by Estill No. 1 of its wastewater treatment facilities and services to Irvine Utility Commission is a transaction subject to the jurisdiction of the Public Service Commission and requires Commission approval.⁴⁶

7. Due to its financial assets and its status as a department of the City as a municipal corporation, Irvine Utility Commission has sufficient financial integrity to ensure the continuity of utility service.

8. Irvine Utility Commission has sufficient managerial and technical ability to ensure the continuity of utility service.

9. Irvine Utility Commission has the financial, technical, and managerial abilities to provide reasonable service to the present wastewater customers of Estill No.

1.

⁴⁶ KRS 278.020(5) and (6).

10. The transfer of ownership and control of Estill No. 1's wastewater facilities and services to Irvine Utility Commission is consistent with regional planning efforts and Estill No. 1's agreement with the Kentucky Division of Water.

11. The transfer is in accordance with the law, for a proper purpose, and is consistent with the public interest.

12. Upon completion of the proposed transaction, the provision of wastewater service to the present wastewater customers of Estill No.1 will no longer be subject to Commission jurisdiction.

IT IS THEREFORE ORDERED that:

1. The transfer of Estill No. 1's wastewater facilities, services, and customers to the City, through its Irvine Utility Commission, is approved.

2. Estill No. 1 shall be responsible for submitting to the Commission all financial and statistical reports, as described in 807 KAR 5:006, Section 4, including reports for the period in 2015 in which it owns and operates wastewater facilities.

3. Estill No. 1 and Irvine Utility Commission shall notify the Commission in writing of the transfer of assets within 10 days of the transfer's occurrence.

4. Upon the receipt of any approval described in part 14.a. of the Agreement,⁴⁷ Estill No. 1 and Irvine Utility Commission shall notify the Commission in writing of the approval within 10 days of the receipt and shall identify any remaining approvals necessary or state that all approvals have been obtained.

⁴⁷ Joint Application, Exhibit A, Memorandum Settlement Agreement, at 8.

5. Upon the receipt of any written assurance described in part 14.b of the Agreement,⁴⁸ Estill No. 1 and Irvine Utility Commission shall notify the Commission in writing of the written assurance within 10 days of the receipt and shall identify any remaining assurances necessary or state that all assurances have been obtained.

6. Upon the receipt of any assurance described in part 14.c. of the Agreement,⁴⁹ Estill No. 1 and Irvine Utility Commission shall notify the Commission in writing of the assurance within 10 days of the receipt and shall identify any remaining assurances necessary or state that all assurances have been obtained.

7. Estill No. 1 and Irvine Utility Commission shall notify the Commission in writing of any satisfaction or release from liability relating to Estill No. 1's indebtedness held by Rural Development within 10 days of the satisfaction or release.

8. Sixty days from the date of this Order, and every 60 days thereafter, Estill No. 1 shall file with the Commission a report on the status of its efforts to complete the transfer of its wastewater facilities.

9. Any documents filed pursuant to ordering paragraphs 3, 4, 5, 6, 7, and 8 shall reference this case number and shall be retained in the Estill No. 1's general correspondence file.

10. The Executive Director is delegated authority to grant reasonable extensions of time for the filing of any documents required by this Order upon a showing of good cause for such extension.

11. This case shall be closed and removed from the Commission's docket.

⁴⁸ *Id.*

⁴⁹ *Id.*

By the Commission

ENTERED
FEB 13 2015
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

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