

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF MOUNTAIN WATER)	CASE NO.
DISTRICT FOR AN ADJUSTMENT OF WATER)	2014-00342
AND SEWER RATES)	

ORDER

Mountain Water District ("Mountain District") applied for an adjustment of its water and sewer rates pursuant to the procedures set forth in 807 KAR 5:001, Section 16. Mountain District proposed water rates that would produce additional revenues of \$2,550,075, or 33.5 percent, over operating revenues from existing water rates of \$7,620,897; and sewer rates that would produce additional revenues of \$1,673,407, or 188.34 percent, over operating revenues from existing sewer rates of \$888,494. For the district as a whole, the applied-for rates would produce additional revenue of \$4,223,482, or approximately 49.6 percent more than the current \$8,509,391.

By this Order, the Commission establishes water rates that will produce an annual increase in revenues from water sales of \$1,265,720 and sewer rates that will produce an annual increase in revenues from sewer service of \$1,505,720. The total of \$2,771,440 is an increase of approximately 32.6 percent over current total revenue.

Because of the magnitude of the increase in sewer rates, and in keeping with the Commission practice of gradualism to mitigate rate shock, the rate adjustments are to be implemented in three phases over two years. In order to provide Mountain Water

with consistent annual revenue, water rates are being temporarily set at a higher level than the final increase, and will decline as sewer rates rise.

This will gradually reduce the long-standing subsidization of sewer service through water rates. At the end of the two-year period, both water and sewer rates will more closely reflect the cost of providing those services.

Our action will increase the monthly bills for a residential customer with a 5/8-inch by 3/4-inch meter that uses 5,000 gallons of water monthly as follows: the bill for water service initially will increase from \$41.05 to \$53.28, or 29.8 percent, and will decline to \$47.89 – a 16.6 percent increase over current rates – in two years; and the bill for sewer service initially will increase from \$32.00 to \$50.08, or 56.5 percent, and will rise to \$86.24 – a total increase of 169.5 percent – at the end of the two-year phase-in period.

BACKGROUND

Mountain District is a water district organized pursuant to KRS Chapter 74. It owns and operates water treatment and distribution facilities that provide retail water service to approximately 17,145 customers in Pike County, Kentucky and wholesale water service to Mingo County Public Service District (located in West Virginia), Martin County Water District, the city of Jenkins, Kentucky, and the city of Elkhorn, Kentucky.¹ Mountain District's sewer division owns and operates sewage collection facilities in Pike and Floyd counties, Kentucky, that serve 2,178 residential customers and 194

¹ *Annual Report of Mountain Water District Water Division to the Public Service Commission of the Commonwealth of Kentucky for the Calendar Year Ended December 31, 2013* ("2013 Water Annual Report") at 12, 53, and 59.

commercial customers.² Its last general rate adjustment for the water division occurred in December 1997.³

PROCEDURE

On September 25, 2014, Mountain District notified the Commission in writing of its intent to apply for a general adjustment of water and sewer rates using a historical test year. On November 20, 2014, Mountain District tendered its application ("Application"). After Mountain District corrected filing deficiencies, its Application was accepted for filing on December 11, 2014. The Commission established this docket and permitted the Attorney General of Kentucky ("AG") to intervene in this matter.

In its December 23, 2014 Order, the Commission established a procedural schedule to ensure the orderly review of Mountain District's Application. After Mountain District filed a revised tariff complying with the requirements of KRS 278.180(1) and 807 KAR 5:011, Section 9, the Commission issued an Order on January 9, 2015, suspending the operation of the proposed rates for a period of five months from their proposed effective date of January 11, 2015, up to and including June 10, 2015.

Following extensive discovery, the Commission held an evidentiary hearing in this matter on May 20, 2015, in Frankfort, Kentucky.⁴ The Commission also held a

² *Annual Report of Mountain Water District Sewer Division to the Public Service Commission for the Calendar Year Ended December 31, 2013* at 9 and 25.

³ Case No. 1996-00126, *In the Matter of an Investigation into the Operations and Management of Mountain Water District* (Ky. PSC Aug. 11, 1997).

⁴ The following persons testified at the evidentiary hearing on behalf of Mountain District: Kevin Howard, P.E., Vice President of Summit Engineering; Roy Sawyers, Mountain District Administrator; Michael Spears, CPA; Grondall Gene Potter II, Utility Management Group ("UMG") Project Manager; and Rob Meyer, UMG Corporate Financial Office. The AG did not sponsor any witnesses.

public meeting in Pikeville, Kentucky, on April 16, 2015, to receive public comment on the proposed rate adjustment. All parties submitted written briefs following the conclusion of the evidentiary hearing.

ANALYSIS AND DETERMINATION

Test Year

Mountain District proposes to use as its historical test year the 12-month period ending June 30, 2014, as adjusted for known and measurable changes. The Commission finds the use of this period reasonable.

Income Statement

For the test year, Mountain District reported actual operating revenues and expenses for its water division of \$7,620,897 and \$8,954,342,⁵ respectively.⁶ Mountain District proposed several adjustments to the water division's operating expenses to reflect current and anticipated operating conditions resulting in pro forma operating expenses of \$9,521,847.⁷

For the test year, Mountain District reported actual operating revenues and expenses for its sewer division of \$888,739 and \$2,431,895, respectively.⁸ Mountain District proposed several adjustments to the sewer division's operating expenses to

⁵ \$6,265,396 (Operating Expenses) + \$3,444 (Amortization) + \$11,816 (Payroll Taxes) + \$2,673,686 (Depreciation Expense) = \$8,954,342.

⁶ Application, Exhibit B-1, Schedule W-B, Pro Forma Adjustments to Historic Test Year at 1-2.

⁷ *Id.* \$6,832,901 (Pro Forma Operating Expenses) + \$3,444 (Pro Forma Amortization) + \$11,816 (Pro Forma Payroll Taxes) + \$2,673,686 (Depreciation Expense) = \$9,521,847.

⁸ Application, Exhibit B-5, Schedule S-B, Pro Forma Adjustments to Historic Test Year at 1-2.

reflect current and anticipated operating conditions resulting in pro forma operating expenses of \$2,448,647.⁹

The Commission's review of Mountain District's pro forma adjustments for its water and sewer divisions is set forth below.

Stand-Alone Analysis. Mountain District executed a new management contract with UMG on March 27, 2014.¹⁰ The term of the March 27, 2014 management contract was for three years commencing on January 1, 2014, and ending on December 31, 2016.¹¹ The contract allows for either party to terminate the agreement, without cause, at the end of the second year and with 180 days prior notification.¹² Mountain District agreed to pay to UMG an annual fee of \$7,680,850 (\$640,070.83 per month) in calendar year 2014 and an annual fee of \$ \$7,757,660 in calendar years 2015 and 2016.¹³

The total test-year UMG management fee was \$7,349,659, of which Mountain District allocated \$5,887,776¹⁴ to its water division and the remaining \$1,461,883¹⁵ to its

⁹ *Id.*

¹⁰ Application, Exhibit O, Agreement for Operations, Maintenance and Management Services at 1.

¹¹ *Id.*, Paragraph 11.1, Term, Termination and Default at 14.

¹² *Id.*

¹³ *Id.*, Paragraph 7.1, Compensation at 11.

¹⁴ Application, Exhibit B-2, Schedule W-B at 1. \$5,812,426 (Contract Services – UMG Management) + \$465,864 (Contract Services – R&M) - \$350,460 (Contract Services – Assumed Expenses by UMG) - \$40,054 (R&M Overage) = \$5,887,776.

¹⁵ Application, Exhibit B-5, Schedule S-B at 1. \$1,224,408 (Contract Services – UMG Management) + \$98,136 (Contract Services – R&M) - \$73,830 (Contract Services – Assumed Expenses by UMG) + \$213,168 (R&M Overage) = \$1,461,882.

sewer division. Mountain District proposed to increase the UMG management fee by \$250,026 to reflect: a 1 percent management fee increase of \$76,009;¹⁶ a 3 percent estimated electric rate increase of \$33,288; an annual 1 percent adjustment of \$41,500; and the elimination of the final loan forgiveness of \$99,229. The pro forma UMG management fee being allocated to the water and sewer divisions is \$6,121,050¹⁷ and \$1,478,635,¹⁸ respectively.

Because Mountain District stated that it did not know exactly how much it would cost to operate the district without a third-party contractor, the AG argues that Mountain District was unaware whether the UMG contract price was a benefit or detriment to the ratepayers.¹⁹ The AG points to Mountain District's analysis that showed "it would see initial cost savings of at least \$374,565 if operations were brought back in-house."²⁰ The AG takes issue with the following two basic assumptions in Mountain District's analysis: (1) Mountain District's staffing levels would remain the same as UMG; and (2) the UMG repair and maintenance budget is reasonable and documented by evidence.²¹

¹⁶ Mountain District states that the 1 percent increase is required by the Agreement, but the Agreement does not specifically mention a 1 percent management fee increase. The difference between the 2014 and 2015 annual management fee is 1 percent, and there is no increase in the management fee in 2016.

¹⁷ Application, Exhibit B-2, Schedule W-B at 1. \$5,870,550 (Contract Services – UMG Management) + \$29,762 (3% Increase Purchased Power Increase) + \$470,523 (Contract Services – R&M) + \$41,500 (Annual 1% Adjustment) - \$251,231 (Contract Services – Assumed Expenses by UMG) - \$40,054 (R&M Overage) = \$6,121,050.

¹⁸ *Id.*, Exhibit B-5, Schedule S-B at 1. \$1,236,654 (Contract Services – UMG Management) + \$3,526 (3% Increase Purchased Power Increase) + \$99,117 (Contract Services – R&M) - \$73,830 (Contract Services – Assumed Expenses by UMG) + \$213,168 (R&M Overage) = \$1,478,635.

¹⁹ Attorney General's Post-Hearing Brief ("AG's Brief") at 19.

²⁰ *Id.* at 9.

²¹ *Id.*

The AG states that Mountain District's analysis ". . . simply carried over 100 percent of the contractor's employees, which included two executive assistants, two customer service managers, an Operations Manager, a Senior Project Manager, an Electrical Maintenance Manager, an HR Director, a Safety Officer, and seven separate area Managers, among a multitude of hourly employees who were deemed to be necessary to run the day to day operations."²² According to the AG, the only salary study provided by Mountain District was a comparison performed by UMG of its contractor positions to the Kentucky Rural Water Association ("KRWA") salary survey and not the possible consolidated positions.²³ The AG adds that this analysis shows that the contractor positions were at or above the maximum KRWA salary range, thus demonstrating that UMG's salaries are on average higher than the other Rural Water Districts in the Commonwealth.²⁴

The AG contends that the annual repair and maintenance ("R&M") budget has increased every year since the inception of the UMG contract in 2005.²⁵ According to the AG, the R&M increases have been so substantial that in the March 27, 2014 contract, UMG forgave \$118,932 of the R&M overage because Mountain District did not have sufficient funds to pay the contract fee, the R&M overage, and its required bond payments.²⁶ The AG points to Mountain District's claim that its employees have oversight of every invoice billed as an R&M expense, but Mountain District was unable

²² *Id.* at 9–10.

²³ *Id.* at 10.

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.*

to point to an example where an R&M work order was rejected or denied.²⁷ Because UMG pays some R&M expenses out of pocket and Mountain District pays some directly, the AG states that Mountain District “cannot illuminate a clear path for how these vendor payments get paid, billed or logged.”²⁸

The AG states that Mountain District’s response to Item 14 of the Post-Hearing Data Request lacks detail or analysis, and contradicts the term in the March 27, 2014 UMG contract, wherein \$118,932 of the R&M overage was to be forgiven upon execution.²⁹ The AG adds that, “[t]here is no incentive for UMG to keep the R&M costs low, as any amount that exceeds the set fee is repaid through R&M overage account.”³⁰ For these reasons, the AG argues that there is no credible evidence to show what the R&M budget would be if the District returned the operations back in-house.³¹

The AG argues that Mountain District failed to eliminate the Corporate Fee of \$300,000 and the Corporate Overhead of \$467,927 from its stand-alone analysis, which “would inure to the rate payers, should the District return to independent operations.”³² The AG concludes that Mountain District’s financial analysis is not comprehensive, and “failed to consider the savings that would inure to the ratepayers if UMG profits were eliminated.”³³

²⁷ *Id.* at 11.

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.*

³¹ *Id.* at 12.

³² *Id.*

³³ *Id.*

The Commission agrees with the arguments as presented by the AG. For these reasons, the Commission finds that test-year operating expenses should be adjusted to reflect the cost Mountain District would incur if it operated the water and sewer divisions on a stand-alone basis. Accordingly, the Commission removed the cost of the UMG contract from the water division's and sewer division's test-year operations in the amounts \$5,887,776 and \$1,461,883, respectively, and replaced these amounts with the expenses Mountain District would incur on a stand-alone basis. These adjustments are explained below and are accounted for on the pro forma operating statements that appear on pages 27 and 28 of this Order.

Water Division Expenses. In the test year, Mountain District's water division reported the following expenses:

	Test-Year Water
Salaries & Wages	\$ 124,224
Commissioner Fees	30,000
Materials and Supplies	20,077
Accounting	72,550
Legal	39,034
Rental of Building - Real Prop	100
Other Legal PSC Expense	4,918
Education, Dues, and Meetings	31,397
Settlement Expense	3,010
Service Fees	3,730
Bank Service Fees	23,857
Retirement	20,760
Payroll Taxes	11,816
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Total	<u>\$ 385,473</u>

In responding to interrogatories, Mountain District explained that none of the expenses are allocated to the sewer division, but that if the Commission deemed it necessary to allocate the expenses between the two divisions, then 83 percent should

be allocated to the water division and 17 percent to the sewer division. Mountain District did not explain the basis for its allocation or provide supporting documentation.³⁴

The operating expenses in the table above are primarily related to customer service and administrative activities that were incurred by Mountain District for the benefit of both divisions. The Commission finds that there is a direct correlation between these expenses and the number of customers served by each division. Using the ratio of customers served by each division, the Commission is allocating 12.105 percent³⁵ of the expenses to the sewer division, as shown in the table below:

	Test-Year Water	Cost Allocation Between Divisions	
		Water	Sewer
Salaries & Wages	\$ 124,224	(15,037)	\$ 15,037
Commissioner Fees	30,000	(3,632)	3,632
Materials and Supplies	20,077	(2,430)	2,430
Accounting	72,550	(8,782)	8,782
Legal	39,034	(4,725)	4,725
Rental of Building - Real Prop	100	(12)	12
Other Legal PSC Expense	4,918	(595)	595
Education, Dues, and Meetings	31,397	(3,801)	3,801
Settlement Expense	3,010	(364)	364
Service Fees	3,730	(452)	452
Bank Service Fees	23,857	(2,888)	2,888
Retirement	20,760	(2,513)	2,513
Payroll Taxes	11,816	(1,430)	1,430
Total	\$ 385,473	(46,661)	\$ 46,661

Purchased Water. The reported test-year purchased water expense for Mountain District's water division was \$1,114,660.³⁶ According to Mountain District, the test-year

³⁴ Mountain District's Responses to Commission Staff's Second Request for Information ("Staff's Second Request"), Item 18.

³⁵ $2,357$ (Sewer Division Customers) + $17,115$ (Water Division Customers) = $19,472$ (Total System Customers). $2,357$ (Sewer Division Customers) ÷ $19,472$ (Total System Customers) = 12.105%.

³⁶ Mountain District's Responses to Commission Staff's First Request for Information ("Staff's First Request"), Item 2, MWD Department P and L, for 12 Periods from 7/1/2013 to 6/30/2014, Transmission/Distribution at 2.

water loss for its water division was 27 percent. However, the Commission has determined that the actual test-year water loss was 29.32 percent, as calculated below:

Water Produced/Purchased	1,677,079,000
Less: Water Sales	(959,939,000)
Other Water Used	<u>(225,414,000)</u>
Line Loss - Gallons	<u>491,726,000</u>
Divide by: Water Produced/Purchased	1,677,079,000
Line Loss - Percentage	<u><u>29.320%</u></u>

Because Mountain District is the combination of four different water utilities, it “is unsure of the condition of the facilities it inherited or the previous practice and procedures of installation, repairs, and routine maintenance performed by those districts.”³⁷ Mountain District attributes the excessive water loss to inaccurate meters, theft of service, and infrastructure failure caused by climate, soil corrosion, and improper installation.³⁸

Mountain District states that it operates a complex system in the largest county in the state, with sparse population density and mountainous terrain.³⁹ According to Mountain District, it has since its inception maintained a Water Loss Program that encompasses: (1) use of a leak detection crew; (2) master meter monitoring; (3) accuracy testing on residential and commercial meters; (4) monitoring of troubled areas for leaks; and (5) a service line replacement program.⁴⁰

³⁷ Mountain District’s Responses to the Commission Staff’s Third Request for Information Clarification Responses (“Staff’s Third Request – Clarification”), Item 15.b.

³⁸ *Id.*

³⁹ *Id.*

⁴⁰ *Id.*

Mountain District's goal is to reduce its water loss to 25 percent in five years and to reduce water loss to 20 percent in ten years.⁴¹ Mountain District currently identifies and ranks locations that have the most water loss issues.⁴² Based upon that analysis, Mountain District will begin replacement of the identified infrastructure to meet its water loss percentage goals.⁴³ However, Mountain District admits that until a funding source is located, it will be unable to reach its water loss goals.⁴⁴

Mountain District is requesting that the Commission grant it a deviation from 807 KAR 5:066, Section 6(3), but the AG argues that "[t]he District has not submitted any credible evidence sufficient to meet the burden of proof to establish an alternative level and the request should be denied."⁴⁵ Although Mountain District's Water Loss Control Program has been in place since 2005, the AG contends that "there has been no documented improvement or reduction in the water loss since its inception."⁴⁶ According to the AG, Mountain District's proposal to reduce water loss to 20 percent is not supported by any specific activity contained in the existing Water Loss Plan. Mountain District made no mention of conducting an audit or working on the metering system, and the plan did not contain "any hard evidence to support this goal."⁴⁷

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ AG's Brief at 12.

⁴⁶ *Id.* at 13.

⁴⁷ *Id.*

Arguing that Mountain District has not met its burden of proof, the AG proposes to deny the requested deviation and asserts that the Commission should disallow any costs, including purchased power and chemicals, above the 15 percent allowable water loss limitation.⁴⁸ The AG further proposes that the Commission require Mountain District to “prepare and submit a comprehensive Water Loss Plan, which includes details of sufficient specificity for funds to support the plan, within six months of the entry of an Order in this underlying action.”⁴⁹

807 KAR 5:066, Section 6(3), states that:

Except for purchased water rate adjustments for water districts and water associations, and rate adjustments pursuant to KRS 278.023(4), for rate making purposes a utility's unaccounted-for water loss shall not exceed fifteen (15) percent of total water produced and purchased, excluding water used by a utility in its own operations. Upon application by a utility in a rate case filing or by separate filing, or upon motion by the commission, an alternative level of reasonable unaccounted-for water loss may be established by the commission. A utility proposing an alternative level shall have the burden of demonstrating that the alternative level is more reasonable than the level prescribed in this section.

807 KAR 5:066, Section 6(3), places the burden upon Mountain District to demonstrate the reasonableness of its alternative level for unaccounted-for water loss. Although Mountain District has identified several infrastructure replacement projects that might reduce its water loss, it has not produced an analysis or study to quantify the impact the identified infrastructure replacements will have upon water loss; neither has it presented a plan as to how it will maintain its target water loss into the future.

⁴⁸ *Id.* at 15.

⁴⁹ *Id.*

The Commission agrees with the AG in that Mountain District has not met its burden to demonstrate that it is capable of reaching or maintaining the alternative level for unaccounted-for water loss of 20 percent. Therefore, the Commission is denying Mountain District's requested deviation from the requirements of 807 KAR 5:066, Section 6(3). Limiting Mountain District's water loss to 15 percent results in a purchased water expense for the water division of \$955,040, as shown in the table below:

Test-year Purchased Water	\$ 1,114,659
Multiplied by: Percentage Water Loss In excess of 15 Percent	<u>-14.320%</u>
Water Loss Limitation	(159,619)
Add: Test Year Purchased Water	<u>1,114,659</u>
Pro Forma Purchased Water - Line Loss Limitation	<u><u>\$ 955,040</u></u>

Mountain District provided a three-year water line replacement schedule that included the estimated construction cost for each identified project.⁵⁰ However, as previously mentioned, Mountain District did not quantify the impact each infrastructure replacement would have on its water loss or identify a plan to finance the total estimated construction cost of \$953,000.

The Commission finds that within 90 days from the date of this Order, Mountain District should: (1) identify the sources of the excessive water loss; (2) quantify the water loss from each source; (3) prioritize the identified water-loss projects; (4) establish a time schedule for eliminating each source of water loss; and (5) provide an estimated cost for each identified project. The Commission further finds that within 120 days from

⁵⁰ Mountain District's Responses to the Staff's Third Request - Clarification, Item 15.b.(3).

the date of this Order, Mountain District should provide a detailed plan⁵¹ to fund each identified water loss project that specifically identifies credible funding sources.

Purchased Power. Mountain District proposes to increase purchased-power expense to reflect an anticipated 3 percent increase in Kentucky Power Company's rates by increasing the operating expenses for its water division and its sewer division by \$29,762 and \$12,244, respectively.⁵² The test-year electric expense for the water division was \$828,846, and the electric expense for the sewer division was \$333,804.⁵³

On June 26, 2015, the Commission issued its final Order in Case No. 2014-00396⁵⁴ granting Kentucky Power Company an overall increase of 8.1 percent. Since an adjustment to reflect Kentucky Power Company's increased rates would meet the ratemaking criteria of being known and measurable, the Commission is increasing the test-year purchased power expense for the water and sewer division to reflect Kentucky Power Company's 8.1 percent rate increase as shown in the table below:

	<u>Water Division</u>	<u>Sewer Division</u>
Test-Year Purchased Power	\$ 828,846	\$ 333,804
Multiplied by: Overall Rate Increase - Kentucky Power	<u>108.100%</u>	<u>108.100%</u>
Pro Forma Purchased Power	<u>\$ 895,983</u>	<u>\$ 360,842</u>

⁵¹ The Commission has included depreciation expense of \$2,071,674 in the water division's pro forma operating expenses. Mountain District's funding plan should include reinvestment of the depreciation expense in its infrastructure replacement as suggested by the Kentucky Division of Water.

⁵² Application, Exhibit B-2, Schedule W-B at 1, and Exhibit B-5, Schedule S-B at 1.

⁵³ Mountain District's Responses to the Post Hearing Information requests, Item 21.

⁵⁴ Case No. 2014-00396, *Application of Kentucky Power Company for: (1) A General Adjustment of its Rates for Electric Service; (2) An Order Approving Its 2014 Environmental Compliance Plan; (3) An Order Approving Its Tariffs and Riders; and (4) An Order Granting all Other Required Approvals and Relief* (Ky. PSC June 26, 2015).

The Commission is reducing the purchased-power expense for the water division by \$128,305⁵⁵ to remove from Mountain District's test-year operations the cost of pumping the excess water loss. The pro forma purchased power expense for the water division is \$767,678.⁵⁶

Chemicals. The test-year chemical expense for the water division and the sewer division was \$104,428 and \$65,637, respectively.⁵⁷ The Commission is reducing the chemical expense for the water division by \$14,954⁵⁸ to remove from Mountain District's test-year operations the cost of treating the excess water loss. The pro forma chemical expense for the water division is \$89,474.

Maintenance and Repairs. The test-year maintenance and repair expense for the water division and the sewer division was \$425,237 and \$311,306, respectively.⁵⁹ In reviewing the schedule of test-year maintenance and repair expenses provided in the post hearing information request, the Commission determined that the items in the following table are capital expenditures that should not be reported as operating expenses.

⁵⁵ $\$895,100$ (Pro Forma Electric – Purchased Water) \times 14.32% (Excess Water Loss) = \$128,305.

⁵⁶ $\$895,983 - \$128,305 = \$767,678$.

⁵⁷ Application, Exhibit B, Appendix C, Table 1.

⁵⁸ $\$104,428$ (Test-year Chemicals – Water) \times 14.32% (Excess Water Loss) = \$14,954.

⁵⁹ Mountain District's Responses to the Post-Hearing Information Requests, Item 21.

Vendor	Description	Amount
Water Division		
Consolidated Pipe and Supply	Meter Service Parts	\$ (6,333)
Micro Comm	Greasy Creek Tank	(8,800)
Wascon	Pump	(16,375)
Total Water Capital Expenditures		<u>\$ (31,508)</u>
Sewer Division		
Southern Sales	Grinder Pumps	\$ (7,463)
Wascon	Grinder Pumps	(169,331)
Total Sewer Capital Expenditures		<u>\$ (176,794)</u>

Accordingly, Commission is including repair and maintenance expense for the water division of \$393,729⁶⁰ and for the sewer division of \$134,512.⁶¹

Rate Case Amortization. Mountain District proposed to increase its water division's operating expenses by \$41,500 to reflect amortizing estimated rate case expense of \$124,500.⁶² The actual cost Mountain District incurred to prepare and pursue its request for rate adjustment was \$147,453.⁶³ The Commission has reviewed the invoices supplied by Mountain District and finds that the rate case cost is reasonable. Amortizing actual rate case cost over three years results in an amortization expense of \$49,151. Using the ratio of customers served by each division, the Commission is allocating \$43,201 to the water division and \$5,950 to the sewer division.

Tank Inspections. On July 27, 2011, Mountain District entered into a Water Tank Management Agreement ("Water Tank Agreement") with Southern Corrosion, Inc. for

⁶⁰ \$425,237 (Water Division Repair and Maintenance) – \$31,408 (Capital Expenditures) = \$393,729.

⁶¹ \$311,306 (Sewer Division Repair and Maintenance) – \$176,794 (Capital Expenditures) = \$134,512.

⁶² Application, Exhibit B, Appendix D, PSC Rate Case Expense.

⁶³ Mountain District's Response to Post Hearing Information Requests, Item 13.

the annual inspection and repair of its water tanks.⁶⁴ The Water Tank Agreement requires annual premiums of \$334,231 for the first five years of the service and a premium of \$161,154 for the sixth year of service.⁶⁵ On August 13, 2013, Mountain District and Southern Corrosion amended the Water Tank Agreement, noting that Mountain District was experiencing cash-flow problems and that all work on this project would be suspended for 18 months.⁶⁶ Mountain District proposes to increase the water division's test-period operating expenses by \$334,231 to reflect the continuation of the Water Tank Agreement.⁶⁷

On April 29, 2015, Mountain District and Southern Corrosion amended the Water Tank Agreement to reflect that within six months of the date of the amendment, one identified tank would be repainted and that the previous work schedule would be restarted 90 days after Mountain District's new rate structure is implemented.⁶⁸

Given the recent failure of a water storage stand-pipe owned and operated by U.S. 60 Water District of Shelby and Franklin Counties⁶⁹ the Commission is aware of the importance for the water utilities that are under its jurisdiction to maintain a routine maintenance program to inspect and repair all of their tanks. Further, the requirements

⁶⁴ Application, Exhibit B, Appendix G, Water Tank Management Agreement.

⁶⁵ *Id.*, Pricing & Terms.

⁶⁶ Mountain District's Responses to Post Hearing Information Requests, Item 1.a.

⁶⁷ Application, Exhibit F, Pro Forma Financial Statements, Notes to the Pro Forma Financial Statements at 6.

⁶⁸ Mountain District's Responses to Post Hearing Information Requests, Item 1.b.

⁶⁹ Case No. 2015-00037, *U.S. 60 Water District Alleged Failure to Comply with 807 KAR 5:006, Sections 26 and 27, and 807 KAR 5:066, Section 7* (Ky. PSC Aug. 17, 2015).

of the April 29, 2015 amended Water Tank Agreement make Mountain District's adjustment known and measurable. Prior to the agreement with Southern Corrosion, Mountain District had not incurred any expense for tank inspections. Accordingly, the Commission is increasing the test-year operating expenses for the water division by the full amount of \$334,231.

Operational Costs. Mountain District attempted to show how much it would cost if there were no third-party contract operator by using UMG's core expenses adjusted for appropriate assumptions.⁷⁰ Mountain District's analysis showed that there would be an expected cost savings of approximately \$374,565 if the UMG agreement were to be eliminated.⁷¹ The costs shown in Mountain District's analysis are for a combined water and sewer operation and were obtained from a response to a Commission Staff data request.⁷²

According to the AG, however, Mountain District's analysis does not reflect the elimination of the corporate fee and corporate overhead of \$300,000 and \$467,927, respectively.⁷³ Another flaw with Mountain District's analysis alleged by the AG is that there were no adjustments made to UMG staffing levels; the analysis simply carried over 100 percent of UMG's employees with no consideration given to consolidating or eliminating employee positions.⁷⁴

⁷⁰ Mountain District Clarification Responses to Commission Staff's Third Request for Information ("Staff's Third Request") to Mountain District, Item 18.c.

⁷¹ *Id.*

⁷² Mountain District's Responses to Staff's Second Request, Item 2.

⁷³ AG's Brief at 12.

⁷⁴ *Id.* at 9.

In reviewing the UMG cost information, the Commission agrees with the AG that the corporate fees and overheads were reported in the category corporate and other expenses of \$922,725.⁷⁵ The only costs from this category included in Mountain District's analysis are for the following employee positions: Human Resource, Safety, and Accounts Payable Clerk. Further, Mountain District correctly assumed that in order to maintain the same level of customer service, it should include the number of employee positions that UMG currently has dedicated to operating Mountain District. Until a more thorough and detailed analysis is performed by an unaffiliated outside consultant, this is a reasonable assumption.

The Commission has broken down the costs included in the analysis into two categories: direct operational costs and indirect operational costs.

1) Direct Operational Costs. The following costs are reported as the direct operational costs for the water and the sewer divisions. The Commission has reviewed the direct operational costs and finds that they are within a range of reasonableness and they have been included in the operating expense of the water and sewer divisions.

⁷⁵ Mountain District's Responses to Staff's Second Request, Item 2, Administrative, Corporate and Other Expenses.

	Totals	Water	Sewer
Salaries and Wages	\$ 1,205,068	\$ 1,048,574	\$ 156,494
Payroll Taxes	101,615	88,059	13,556
Gasoline	136,192	97,758	38,434
Diesel	36,469	36,468	0
Miscellaneous	1,469	891	578
Janitorial Expense	7,194	6,608	586
Workers' Compensation	28,048	23,165	4,883
Mobile	9,361	6,668	2,693
Uniforms	23,454	17,808	5,646
Safety Supplies	14,846	9,559	5,287
Laboratory Supplies	2,978	1,898	1,080
Laboratory Testing	37,172	1,305	35,867
Other Outside Services	2,400	0	2,400
Sewage Fees	163,514	0	163,514
Solid Waste	6,805	0	6,805
Total Direct Operational Costs	<u>\$ 1,776,585</u>	<u>\$ 1,338,761</u>	<u>\$ 437,823</u>

2) Indirect Operational Costs. There are numerous expenses identified as indirect costs that Mountain District or UMG did not allocate between the two divisions. The Commission finds that there is a direct correlation between these expenses and the number of customers served by each division. Using the ratio of customers served by each division, the Commission is allocating 87.895 percent to the water division and 12.105 percent of the expenses to the sewer division, as shown in the table below:⁷⁶

⁷⁶ 2,357 (Sewer Division Customers) + 17,115 (Water Division Customers) = 19,472 (Total System Customers). 17,115 (Water Division Customers) ÷ 19,472 (Total System Customers) = 87.895 percent. 2,357 (Sewer Division Customers) ÷ 19,472 (Total System Customers) = 12.105 percent.

	Total	Allocated	
		Water 87.895%	Sewer 12.105%
Multiplied by: Customer Allocation			
Indirect Salaries and Wages	\$ 826,425	\$ 726,386	\$100,039
Payroll Taxes	74,609	65,578	9,031
Pensions and Benefits	766,047	673,317	92,730
Training	5,505	4,839	666
Travel - Lodging, Meals, and Mileage	11,031	9,696	1,335
Vehicle Lease	-	-	-
Gasoline	38,770	34,077	4,693
Miscellaneous	588	517	71
Office Storage Rental	1,090	958	132
Office Equipment Lease	7,253	6,375	878
Office Supplies	31,930	28,065	3,865
Janitorial Expense	12,898	11,337	1,561
Postage	111,210	97,748	13,462
Professional Fees Accounting	749	658	91
Professional Fees Other	47,941	42,138	5,803
General Liability	149,073	131,028	18,045
Auto Insurance	15,417	13,551	1,866
Workers' Compensation-Allocated	7,656	6,729	927
Office	11,736	10,315	1,421
Mobile	4,487	3,944	543
Other	1,910	1,679	231
Security	459	403	56
Uniforms	3,043	2,675	368
Safety Supplies	1,428	1,255	173
Total	\$2,131,255	\$1,873,267	\$257,988

Depreciation. The test-year depreciation expense for the water division and the sewer division was \$2,673,688 and \$970,013, respectively.⁷⁷ Mountain District states that it has not performed a depreciation study, but the attached schedules accurately reflect its plant.⁷⁸

⁷⁷ Application, Exhibit B-2, Schedule W-B at 2 and Exhibit B-5, Schedule S-B at 1.

⁷⁸ *Id.*

In a previous decision, the Commission noted that a depreciation study requires detailed information and is expensive to complete, and, therefore, no water district operating under the Commission's jurisdiction has an approved study.⁷⁹ The absence of a depreciation study does not prevent the Commission from reviewing the depreciation practices of those utilities.⁸⁰ Historically, the Commission has relied upon the National Association of Regulatory Utility Commissioners ("NARUC") Study of Depreciation Practices for Small Water Utilities ("NARUC Study"), dated August 15, 1979, to evaluate the reasonableness of a water utility's depreciation practices.⁸¹ The NARUC Study outlines expected life ranges for asset groups, and an adjustment is made when a water utility is using a depreciation life that falls outside this range.⁸²

Mountain District uses a 40-year depreciation life for the majority of its transmission and distribution mains, while the NARUC Study has a depreciation life range of 50 to 75 years for this asset group and a mid-point life of 62.5 years. According to Mountain District, a depreciation life of 62.5 years is an unreasonable life expectancy for water mains installed in rocky and mountainous terrain.⁸³ Mountain District explains that using a 50-year depreciation life for transmission distribution mains is acceptable, given Mountain District's unusual terrain and its repair/replacement

⁷⁹ Case No. 2006-00398, *Application of Northern Kentucky Water District for Approval of Depreciation Study* (Ky. PSC Nov. 21, 2007) at 3.

⁸⁰ *Id.*

⁸¹ *Id.*

⁸² *Id.* at 3–4.

⁸³ Mountain District's Responses to Staff's Third Request, Item 20.c.

schedule.⁸⁴ Mountain District adds that a 50-year life is supported by the NARUC Study, which assigns 50 to 75 years to transmission and distribution mains.⁸⁵

When a water utility has not provided an approved depreciation study or evidence to support its proposed depreciation lives, the Commission has traditionally utilized the mid-point life of the NARUC Study expected life range. In this instance, Mountain District's proposed depreciation life of 50 years for its transmission and distribution mains is solely supported by statements made by its CPA, with no evidence or study to support his conclusions.

Using Mountain District's depreciation Excel spreadsheet, the Commission determined that using a 62.5 depreciation life for all of the listed transmission and distribution mains will decrease depreciation expense by \$602,802.⁸⁶ By also reflecting the increase in depreciation expense for the capital expenditures that were removed from the water division's repairs and maintenance expense of \$788,⁸⁷ the net decrease to water division's depreciation expense is \$602,014.⁸⁸

Depreciating the capital expenditures that were removed from the sewer division's repairs and maintenance expense over 40 years results in an increase to the sewer division's depreciation expense of \$4,420.⁸⁹

⁸⁴ *Id.*

⁸⁵ *Id.*

⁸⁶ \$1,037,196 (Transmission and Distribution Mains 6.5 years) - \$1,639,998 (Current Depreciation) = \$(602,802).

⁸⁷ \$31,508 (Capital Expenditures – Water Division) ÷ 40 years = \$788.

⁸⁸ 788 (Depreciation Capital Expenditures – Water Division) – \$602,802 (Depreciation Adjustment – Transmission and Distribution Mains) = \$602,014.

⁸⁹ \$176,794 (Capital Expenditures – Sewer Division) ÷ 40 (years) = \$4,420.

Short-Term Interest. Mountain District currently owns the seven vehicles that are being used by UMG to operate the water and sewer divisions. During the test year, Mountain District's debt service (principal and interest) for the seven vehicles was \$69,306. UMG makes the monthly debt service payments on behalf of Mountain District and recovers the vehicle debt service through its annual contract fee.⁹⁰

In its analysis to show how much it would cost if it operated the water and sewer divisions on a stand-alone basis, Mountain District determined that it would need five additional vehicles, which would increase the annual vehicle cost from \$69,306 to \$99,306, an increase of \$30,000.⁹¹ In its original analysis, Mountain District incorrectly reported the vehicle debt-service payments as lease payments, but changed this classification to note payments "as they are a cash outflow that MWD is not currently making but would be obligated to fund."⁹²

The note payments listed by Mountain District include both interest and principal payments. Payments of principal are not included as an expense on the income statement, but rather are recorded on the balance sheet as a reduction to the loan balance. Since Mountain District did not separately report the interest and the principal on the note payment, the Commission has not included an allowance for the short-term interest expense in the revenue requirement calculations for the water or the sewer divisions.

⁹⁰ Mountain District's Responses to Informal Conference Questions filed May 14, 2015, Item 3.

⁹¹ *Id.*

⁹² *Id.*

The current arrangement with UMG concerning the payment of the vehicle debt service is not transparent and is overly complicated. It would be simpler to reduce the contract fee by the \$69,306 and let Mountain District make the debt payments itself.

Summary – Income Statement for the Water Division

The table below is a summary of Mountain District's test-year operations for its water division and the Commission's pro forma adjustments.

	Water Division Operations	Pro Forma Adjustments	Pro Forma Operations
Operating Revenues:			
Revenues from Metered Water Sales	\$ 7,622,097	\$ -	\$ 7,622,097
Other Operating Revenues:			
Late Payment Penalties	165,153		165,153
Other Water Service Revenues	244,741		244,741
Connection Fees - Water	146,700		146,700
Total Operating Revenues	8,178,691	0	8,178,691
Operating Expenses:			
Operation & Maintenance:			
Salaries & Wages	124,224	(15,037)	109,187
Commissioner Fees	30,000	(3,632)	26,368
Materials and Supplies	20,077	(2,430)	17,647
Accounting	72,550	(8,782)	63,768
Legal	39,034	(4,725)	34,309
Contract Service - UMG Management	5,887,776	(5,887,776)	0
Rate Case Expense	0	43,201	43,201
Rental of Building - Real Prop	100	(12)	88
Advertising	3,963	(595)	3,368
Other Legal PSC Expense	4,918	(3,801)	1,117
Education, Dues, and Meetings	31,397	(364)	31,033
Settlement Expense	3,010	(452)	2,558
Service Fees	3,730	(2,888)	842
Bank Service Fees	23,857	(2,513)	21,344
Retirement	20,760	(1,430)	19,330
Tank Painting and Repair Contract	0	334,231	334,231
Purchased Water	0	955,040	955,040
Purchased Power	0	767,678	767,678
Chemicals - Total	0	89,474	89,474
Direct Operational Expenses	0	1,338,761	1,338,761
Indirect Operational Expenses	0	1,873,268	1,873,268
Repairs and Maintenance	0	393,729	393,729
Total Operation & Maintenance	6,265,396	(139,055)	6,126,341
Depreciation	2,673,688	(602,014)	2,071,674
Amortization	3,444		3,444
Taxes Other Than Income - Payroll	11,816	(1,430)	10,386
Utility Operating Expenses	8,954,344	(742,499)	8,211,845
Net Utility Operating Income	(775,653)	742,499	(33,154)
Interest Income	3,040		3,040
Income Available for Debt Service	\$ (772,613)	\$ 742,499	\$ (30,114)

Summary – Income Statement for the Sewer Division

The table below is a summary of Mountain District's test-year operations for its sewer division and the Commission's pro forma adjustments.

	Sewer Division Operations	Pro Forma Adjustments	Pro Forma Operations
Operating Revenues:			
Sewer Service Revenues	\$ 888,494	\$ -	\$ 888,494
Connection Fees	1,245		1,245
Total Operating Revenues	889,739	0	889,739
Operating Expenses:			
Operation & Maintenance:			
Salaries & Wages	0	15,037	15,037
Commissioner Fees	0	3,632	3,632
Materials and Supplies	0	2,430	2,430
Accounting	0	8,782	8,782
Legal	0	4,725	4,725
Contract Service - UMG Management	1,461,883	(1,461,883)	0
Rate Case Expense	0	5,950	5,950
Rental of Building - Real Prop	0	12	12
Other Legal PSC Expense	0	595	595
Education, Dues, and Meetings	0	3,801	3,801
Settlement Expense	0	364	364
Service Fees	0	452	452
Bank Service Fees	0	2,888	2,888
Retirement	0	2,513	2,513
Chemicals	0	65,636	65,636
Electricity	0	360,842	360,842
Direct Operational Expenses	0	437,823	437,823
Indirect Operational Expenses	0	257,987	257,987
Repairs and Maintenance	0	134,512	134,512
Total Operation & Maintenance	1,461,883	(153,902)	1,307,981
Depreciation	970,013	4,420	974,433
Payroll Taxes	0	1,430	1,430
Utility Operating Expenses	2,431,896	(148,052)	2,283,844
Net Utility Operating Income	(1,542,157)	148,052	(1,394,105)
Other Income & Deductions:			
Interest Income	19		19
Income Available for Debt Service	\$ (1,542,138)	\$ 148,052	\$ (1,394,086)

REVENUE REQUIREMENT DETERMINATION

Debt Service Water Division

Mountain District proposes a debt service of \$960,552 to reflect its total annual test-year debt payments.⁹³ Using its loan amortization schedules, Mountain District calculated a debt service of \$1,084,805 to reflect a three-year average of its principal and interest payments for the calendar years 2015 through 2017.⁹⁴ Eliminating the debt-service payments for short-term loans, the Commission calculates a three-year average debt service of \$1,029,313, as shown in the table below:

<u>Series</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>Totals</u>	<u>3 Year Avgs.</u>
KIA B291-01	\$ 17,154	\$ 17,154	\$ 17,154	\$ 51,462	\$ 17,154
KIA F01-07	71,538	71,538	71,538	214,614	71,538
KIA B291-07	258,958	258,958	258,958	776,874	258,958
RD 2008	35,945	35,585	36,225	107,755	35,918
RD 2005	91,040	91,005	91,925	273,970	91,323
RD 2001	36,629	37,126	36,606	110,361	36,787
KRWFC	519,068	518,018	515,818	1,552,904	517,635
Totals	<u>\$ 1,030,332</u>	<u>\$ 1,029,384</u>	<u>\$ 1,028,224</u>		<u>\$ 1,029,313</u>

Debt Service Sewer Division

Mountain District proposes a debt service of \$95,431 to reflect its total annual test-year debt payments.⁹⁵ Using its loan amortization schedules, Mountain District calculated a debt service of \$93,028 to reflect a three-year average of its principal and interest payments for the calendar years 2015 through 2017.⁹⁶ Based upon its review of

⁹³ Application, Exhibit B-2, Schedule W-B at 1.

⁹⁴ Mountain District's Responses to Staff's First Request, Item 11.

⁹⁵ Application, Exhibit B-5, Schedule S-B at 1.

⁹⁶ Mountain District's Responses to Staff's First Request, Item 12.

the loan amortization schedules supporting the sewer division's calculation, the Commission finds that it is accurate and has used it in its revenue requirement determination.

Revenue Requirement Water Division

Based upon the Commission's findings and determinations herein, Mountain District's water division requires an increase in revenues of \$1,266,726, determined as follows:

Pro Forma Operation and Maintenance	\$ 6,127,771
Pro Forma Depreciation and Amortization	2,075,118
Pro Forma Payroll Taxes	<u>10,386</u>
Pro Forma Operating Expenses	8,213,275
Plus: Average Annual Debt Principal and Interest Payments	1,029,313
Debt Coverage Requirement	<u>205,863</u>
Total Revenue Requirement	9,448,451
Less: Other Operating Revenue	(556,594)
Non- Operating Revenue	0
Interest Income	<u>(3,040)</u>
Revenue Required from Rates	8,888,817
Less: Normalized Revenues from Water Sales	<u>(7,622,097)</u>
Required Revenue Increase	<u>\$ 1,266,720</u>
Percentage Increase	<u>16.62%</u>

Revenue Requirement Sewer Division

Based upon the Commission's findings and determinations herein, Mountain District's sewer division requires an increase in revenues of \$1,505,720, determined as follows:

Pro Forma Operation and Maintenance	\$ 1,307,981
Pro Forma Depreciation	974,433
Pro Forma Payroll Taxes	<u>1,430</u>
Pro Forma Operating Expenses	2,283,844
Plus: Average Annual Debt Principal and Interest Payments	93,028
Debt Coverage Requirement	<u>18,606</u>
Total Revenue Requirement	2,395,478
Less: Other Operating Revenue	(1,245)
Non- Operating Revenue	0
Interest Income	<u>(19)</u>
Revenue Required from Rates	2,394,214
Less: Normalized Revenues from Water Sales	<u>(888,494)</u>
Required Revenue Increase	<u>\$ 1,505,720</u>
Percentage Increase	<u>169.47%</u>

OTHER ISSUES

Rates

Water Division. To calculate the rates to produce the Staff-calculated revenue requirement, Staff increased current rates by the percentage increase in the Staff-calculated revenue requirement evenly across the board to Mountain District's current rates. This method, which Mountain District also used, allocates the revenue requirement increase to all customers in an equal manner. Mountain Water included a cost-of-service study in its application, but chose to increase all rates in an across-the-board manner as it "avoids the possible confusion that might result from implementing a new rate structure with a customer or service charge and a volumetric rate."⁹⁷ Additionally, this option "provides more revenue stability throughout the year, which

⁹⁷ Application, Exhibit G, P. 5, Pre-filed Testimony of Ray Sawyers

helps the cash flow and helps minimize the need to defer expenses or take other action to meet current operating expenses during low volume months.”⁹⁸

Sewer Division. Mountain District proposed to increase its volumetric rates for sewer customers who received metered water service by an across-the-board percentage increase. For Mountain District’s sewer customers who do not receive metered water service, the Commission previously ordered Mountain District to clearly state whether it will be charging those customers a variable rate or a fixed rate.⁹⁹ In its response on December 11, 2014,¹⁰⁰ Mountain District stated that it would be charging its non-metered sewer customers a flat rate which was calculated by increasing the current average bill across the board by the overall percentage increase in revenues.

Rate Phase-In. The Commission has previously found that an across-the-board percentage increase is an appropriate and equitable method to increase rates in the absence of a cost-of-service study. However, an increase of 169 percent to the sewer division customers will result in rate shock and violates the Commission’s long-recognized principle of gradualism. In prior cases,¹⁰¹ the Commission has found that a phased-in approach to a large rate increase is an appropriate way to manage gradualism in an effort to lessen rate shock. The Commission therefore finds that the 169 percent increase in the sewer division’s rates should be phased in over a two-year

⁹⁸ Application, Exhibit G, page 5, Pre-filed Testimony of Kevin Howard, P.E.

⁹⁹ Case No. 2014-00342, *Application of Mountain Water District for an Adjustment of Water and Sewer Rates* (Ky. PSC Dec. 8, 2014).

¹⁰⁰ Case No. 2014-00342, *Mountain Water District* (Ky. PSC Dec. 11, 2014).

¹⁰¹ See, e.g., Case No. 2012-00152, *Application of Big Sandy Water District for an Adjustment in Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC Mar. 8, 2013) at 5.

period in three phases. During this two-year period, the water division's rates will be adjusted to ensure that Mountain District has the opportunity to collect rates that produce the total revenue requirement determined reasonable herein. The table below summarizes the impact of the phase-in plan on a residential water and sewer customer who purchases 5,000 gallons of water per month through a 5/8-inch by 3/4-inch meter. Also shown in the table is the impact of the phase-in plan on a sewer customer who does not receive water service and is billed a flat monthly sewer rate.

	Current	Phase 1	Phase 2	Phase 3
Metered Customers				
Sewer Service	\$ 32.00	\$ 50.08	\$ 68.16	\$ 86.24
Water Service	41.05	53.28	50.58	47.89
Combined Service	73.05	103.36	118.74	134.13
Unmetered Sewer Customers				
Flat Sewer Rate	29.00	45.39	61.77	78.15

Management Contract

In the ten years that the UMG has been operating as Mountain District, there were seven Amendments to the initial management agreement and a new three-year agreement was executed on March 27, 2014. During that time period, Mountain District did not issue a new RFP or attempt to conduct a benefit analysis to show that the outsourcing of its operations to UMG is beneficial to its ratepayers.

Based on the significant difference between Mountain District's cost under the UMG contract and the stand-alone basis, Mountain District will need to obtain the services of one or more independent consultants who have no prior work experience with Mountain District and have expertise in areas including economic analyses and engineering, to assist in the process described below.

The independent consultants will work with Mountain District to prepare a request for proposals (“RFP”) to be sent to potential bidders who may be interested in operating Mountain District. Once the RFP is developed and sent out, the independent consultants are to assist in the analysis of the bids received. A written report needs to be prepared to document the procedures used to analyze the bids, which should be reviewed based on all relevant factors, including costs and bidder’s qualifications.

Forgivable UMG Loan. The UMG contract amendment dated April 29, 2009, included a \$500,000 forgivable loan that would be amortized over a five-year term and would have an effective interest rate of 5 percent per annum.¹⁰² KRS 278.300(1) provides that “[n]o utility shall issue any securities or evidences of indebtedness, or assume any obligation or liability in respect to the securities or evidences of indebtedness of any other person until it has been authorized so to do by order of the Commission.”

The forgivable \$500,000 loan to Mountain District was clearly an obligation and evidence of indebtedness that Mountain District assumed, and prior Commission approval was therefore required. Mountain District neither requested nor received approval for the loan. Mountain District contends that the loan was not an evidence of indebtedness, as it was a contract for services.¹⁰³ However, this argument conflicts with the fact that the loan bound Mountain District to repay the funds contingent upon maintaining the contract. No actual services were exchanged as a result of this

¹⁰² Mountain District’s Responses to Staff’s First Request, Item 3.c.

¹⁰³ Brief of Mountain District at 23–24.

agreement; the loan was effectively no different from any other financial agreement with a lender.

Accordingly, the Commission finds that the forgivable loan was an evidence of indebtedness subject to Commission approval. In the near future, the Commission will initiate a new proceeding to more thoroughly investigate Mountain District for issuing an evidence of indebtedness without prior Commission approval.

SUMMARY

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

1. The water and sewer rates set forth in Mountain District's Application produce revenue in excess of that found reasonable herein and should be denied.
2. The Phase 1 Water and Sewer rates set forth in Appendix A to this Order should be approved for water and sewer service rendered by Mountain District on and after the date of this Order.
3. The Phase 2 Water and Sewer rates set forth in Appendix B to this Order should be approved for water and sewer service rendered by Mountain District effective the day after the first anniversary of the date of this Order.
4. The Phase 3 Water and Sewer rates set forth in Appendix C to this Order should be approved for water and sewer service rendered by Mountain District effective the day after the second anniversary of the date of this Order.
5. Within 20 days of the date of this Order, Mountain District should file revised tariff sheets with the Commission, using the Commission's electronic Tariff Filing System, setting forth the water and sewer rates approved herein.

6. Within 90 days from the date of this Order, Mountain District should:
 - a. Identify the sources of the excessive water loss;
 - b. Quantify the amount of water loss from each identified source;
 - c. Prioritize the identified water loss projects;
 - d. Establish a time schedule for eliminating each source of water loss;

and

- e. Provide an estimated cost for each identified project.

7. Within 120 days of the date of this Order, Mountain District should provide a detailed plan to fund each identified water loss project, that specifically identifies credible funding sources.

8. Within 180 days of the date of this Order, Mountain District should obtain the services of an outside independent consultant that has no past history with Mountain District, Mountain District's current or former members of the Board of Commissioners, UMG, or UMG's owners to perform the following:

- a. Prepare and issue an RFP to solicit bids from firms interested in providing managerial and operational services to Mountain District; and
 - b. Analyze the bids received based on factors including costs and bidder's qualifications, identify the top response, and document the analysis.

9. Within 240 days of the date of this Order, Mountain District should submit to the Commission a written report that discusses the results of the RFP solicitation for the management of its water and sewer divisions. The report shall include a detailed analysis supporting the decision.

10. In the near future, the Commission will initiate a new proceeding to more thoroughly investigate Mountain District for issuing an evidence of indebtedness without prior Commission approval.

IT IS THEREFORE ORDERED that:

1. The water and sewer rates set forth in Mountain District's Application produce revenue in excess of that found reasonable herein and are denied.

2. The Phase 1 Water and Sewer rates set forth in Appendix A to this Order are approved for water and sewer service rendered by Mountain District on and after the date of this Order.

3. The Phase 2 Water and Sewer rates set forth in Appendix B to this Order are approved for water and sewer service rendered by Mountain District effective the day after the first anniversary of the date of this Order.

4. The Phase 3 Water and Sewer rates set forth in Appendix C to this Order are approved for water and sewer service rendered by Mountain District effective the day after the second anniversary of the date of this Order.

5. Within 20 days of the date of this Order, Mountain District shall file revised tariff sheets with the Commission, using the Commission's electronic Tariff Filing System, setting forth the water and sewer rates approved herein.

6. Within 90 days from the date of this Order, Mountain District shall:

- a. Identify the sources of the excessive water loss;
- b. Quantify the amount of water loss from each identified source;
- c. Prioritize the identified water loss projects;

d. Establish a time schedule for eliminating each source of water loss;
and

e. Provide an estimated cost for each identified project.

7. Within 120 days of the date of this Order, Mountain District shall provide a detailed plan to fund each identified water loss project that specifically identifies credible funding sources.

8. Within 180 days of the date of this Order, Mountain District shall obtain the services of an outside independent consultant that has no past history with Mountain District:

a. Prepare and issue an RFP to solicit bids from firms interested in providing managerial and operational services to Mountain District; and

b. Analyze the bids received based on factors including costs and bidder's qualifications, identify the top response, and document the analysis.

9. Within 240 days of the date of this Order, Mountain District shall submit to the Commission a written report that discusses the results of the RFP solicitation for the management of its water and sewer divisions. The report shall include a detailed analysis supporting the decision.

10. In the near future, the Commission will initiate a new proceeding to more thoroughly investigate Mountain District for issuing an evidence of indebtedness without prior Commission approval.

By the Commission

ENTERED *js*
OCT 09 2015
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

Edward D. Breunell
Executive Director *for*

Case No. 2014-00342

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2014-00342 DATED **Oct 09 2015**

The following water and sewer rates are prescribed for the customers in the area served by Mountain Water District for water and sewer service rendered on and after the date of this Order. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

Monthly Water Rates – Phase 1

5/8- x 3/4-Inch Meter

First 2,000 Gallons	\$25.98 Minimum Bill
Next 8,000 Gallons	9.10 Per 1,000 Gallons
Over 10,000 Gallons	8.07 Per 1,000 Gallons

1-Inch Meter

First 5,000 Gallons	\$53.28 Minimum Bill
Next 5,000 Gallons	9.10 Per 1,000 Gallons
Over 10,000 Gallons	8.07 Per 1,000 Gallons

2-Inch Meter

First 20,000 Gallons	\$179.48 Minimum Bill
Over 20,000 Gallons	8.07 Per 1,000 Gallons

3-Inch Meter

First 30,000 Gallons	\$260.18 Minimum Bill
Over 30,000 Gallons	8.07 Per 1,000 Gallons

4-Inch Meter

First 50,000 Gallons	\$421.58 Minimum Bill
Over 50,000 Gallons	8.07 Per 1,000 Gallons

6-Inch Meter

First 100,000 Gallons	\$825.08 Minimum Bill
Over 100,000 Gallons	8.07 Per 1,000 Gallons

Martin County Water District	\$3.11 Per 1,000 Gallons
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Mingo County Public Service District	\$4.87 Per 1,000 Gallons
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Jenkins Utilities

First 50,000 Gallons Per Day	\$3.11 Per 1,000 Gallons
Over 50,000 Gallons Per Day	\$3.57 Per 1,000 Gallons

Elkhorn City

First 215,000 Gallons Per Day	\$2.92 Per 1,000 Gallons
Over 215,000 Gallons Per Day	\$3.11 Per 1,000 Gallons

Monthly Sewer Rates – Phase 1

Sewer Customers With Metered Water Service

Any customer with both the District's sewer and water service will be billed at the current sewer rates based on the number of gallons of water consumed per month.

Monthly Rates

First 2,000 Gallons	\$21.91 Minimum Bill
Over 2,000 Gallons	9.39 Per 1,000 Gallons

Sewer Customers Without Metered Water Service

Flat Rate	\$45.39 Per Month
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APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2014-00342 DATED **OCT 09 2015**

The following water and sewer rates are prescribed for the customers in the area served by Mountain Water District for water and sewer service effective the day after the first anniversary of the date of this Order. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

Monthly Water Rates – Phase 2

5/8- x 3/4-Inch Meter

First 2,000 Gallons	\$24.66 Minimum Bill
Next 8,000 Gallons	8.64 Per 1,000 Gallons
Over 10,000 Gallons	7.66 Per 1,000 Gallons

1-Inch Meter

First 5,000 Gallons	\$50.58 Minimum Bill
Next 5,000 Gallons	8.64 Per 1,000 Gallons
Over 10,000 Gallons	7.66 Per 1,000 Gallons

2-Inch Meter

First 20,000 Gallons	\$170.38 Minimum Bill
Over 20,000 Gallons	7.66 Per 1,000 Gallons

3-Inch Meter

First 30,000 Gallons	\$246.98 Minimum Bill
Over 30,000 Gallons	7.66 Per 1,000 Gallons

4-Inch Meter

First 50,000 Gallons	\$400.18 Minimum Bill
Over 50,000 Gallons	7.66 Per 1,000 Gallons

6-Inch Meter

First 100,000 Gallons	\$783.18 Minimum Bill
Over 100,000 Gallons	7.66 Per 1,000 Gallons

Martin County Water District	\$2.96 Per 1,000 Gallons
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Mingo County Public Service District	\$4.62 Per 1,000 Gallons
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Jenkins Utilities

First 50,000 Gallons Per Day	\$2.96 Per 1,000 Gallons
Over 50,000 Gallons Per Day	\$3.39 Per 1,000 Gallons

Elkhorn City

First 215,000 Gallons Per Day	\$2.77 Per 1,000 Gallons
Over 215,000 Gallons Per Day	\$2.96 Per 1,000 Gallons

Monthly Sewer Rates – Phase 2

Sewer Customers With Metered Water Service

Any customer with both the District's sewer and water service will be billed at the current sewer rates based on the number of gallons of water consumed per month.

Monthly Rates

First 2,000 Gallons	\$29.82 Minimum Bill
Over 2,000 Gallons	12.78 Per 1,000 Gallons

Sewer Customers Without Metered Water Service

Flat Rate	\$61.77 Per Month
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APPENDIX C

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2014-00342 DATED **OCT 09 2015**

The following water and sewer rates are prescribed for the customers in the area served by Mountain Water District for water and sewer service effective the day after the second anniversary of the date of this Order. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

Monthly Water Rates – Phase 3

5/8- x 3/4-Inch Meter

First 2,000 Gallons	\$23.35 Minimum Bill
Next 8,000 Gallons	8.18 Per 1,000 Gallons
Over 10,000 Gallons	7.25 Per 1,000 Gallons

1-Inch Meter

First 5,000 Gallons	\$47.89 Minimum Bill
Next 5,000 Gallons	8.18 Per 1,000 Gallons
Over 10,000 Gallons	7.25 Per 1,000 Gallons

2-Inch Meter

First 20,000 Gallons	\$161.29 Minimum Bill
Over 20,000 Gallons	7.25 Per 1,000 Gallons

3-Inch Meter

First 30,000 Gallons	\$233.79 Minimum Bill
Over 30,000 Gallons	7.25 Per 1,000 Gallons

4-Inch Meter

First 50,000 Gallons	\$378.79 Minimum Bill
Over 50,000 Gallons	7.25 Per 1,000 Gallons

6-Inch Meter

First 100,000 Gallons	\$741.29 Minimum Bill
Over 100,000 Gallons	7.25 Per 1,000 Gallons

Martin County Water District \$2.80 Per 1,000 Gallons

Mingo County Public Service District \$4.37 Per 1,000 Gallons

Jenkins Utilities

First 50,000 Gallons Per Day	\$2.80 Per 1,000 Gallons
Over 50,000 Gallons Per Day	\$3.21 Per 1,000 Gallons

Elkhorn City

First 215,000 Gallons Per Day	\$2.62 Per 1,000 Gallons
Over 215,000 Gallons Per Day	\$2.80 Per 1,000 Gallons

Monthly Sewer Rates – Phase 3

Sewer Customers With Metered Water Service

Any customer with both the District's sewer and water service will be billed at the current sewer rates based on the number of gallons of water consumed per month.

Monthly Rates

First 2,000 Gallons	\$37.73 Minimum Bill
Over 2,000 Gallons	16.17 Per 1,000 Gallons

Sewer Customers Without Metered Water Service

Flat Rate	\$78.15 Per Month
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