COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ALLEGED FAILURE OF THE CITY OF NORTH MIDDLETOWN TO COMPLY WITH KRS 278.160 AND 278.180 AND THE COMMISSION'S ORDER OF AUGUST 10, 1994 IN ADMINISTRATIVE CASE NO. 351	)	CASE NO. 2006-00072

O R D E R

This matter involves an investigation of the alleged failures of the city of North Middletown, Kentucky ("North Middletown") to comply with certain provisions of KRS Chapter 278. At issue is whether North Middletown willfully failed to file with the Commission its contracts to provide wholesale water service to Judy Water Association ("Judy Water") and adjusted its rate for such service without proper notice to the Commission. Finding in the affirmative, the Commission assesses North Middletown total penalties of $150.

PROCEDURE

Finding that prima facie evidence existed that North Middletown had violated KRS 278.160, KRS 278.180, and the Commission's Order of August 10, 1994 in Administrative Case No. 351[1] by failing to file its contract to provide wholesale water service to Judy Water with the Commission on or before commencing such service and by failing to notify the Commission of its proposed increase in its wholesale water service rate prior to implementing such increase, the Commission ordered North

[1] Administrative Case No. 351, Submission of Contracts and Rates of Municipal Utilities Providing Wholesale Service to Public Utilities (Ky. PSC Aug. 10, 1994).

Middletown to show cause why it should not be penalized for its alleged failures and why it should not be required to refund all monies collected from Judy Water that are in excess of the rate set forth in its contract with Judy Water. North Middletown responded to this Order on March 30, 2006. On June 2, 2006, Commission Staff and North Middletown filed a Stipulation with the Commission. On June 26, 2006, North Middletown filed tariff sheets that reflect its current rate for water service to Judy Water.

On December 14, 2006, the Commission directed that North Middletown submit any request for hearing or submission of briefs within 10 days and that, in the absence of any request, this matter would stand submitted for decision. On January 2, 2007, North Middletown advised the Commission that the matter had been fully briefed. It did not request a hearing in this matter.

STATEMENT OF THE CASE

North Middletown, a city of the fifth class,[2] is located in Bourbon County, Kentucky. It owns and operates a water distribution system that provides water service to residents of North Middletown and wholesale water service to Judy Water.

In October 1999, after negotiations between North Middletown and Judy Water, the parties executed a water purchase contract. Under the terms of this contract, North Middletown agreed to sell Judy Water a maximum of 2,100,000 gallons of water per month at a rate of $1.95 per 1,000 gallons. This contract further provided that North Middletown would be permitted to pass through all increases in price from its supplier, Kentucky-American Water Company ("KAWC"), to Judy Water according to the methodology set forth in Administrative Regulation 807 KAR 5:068.

[2] KRS 81.010(5).

In April 2000, Judy Water applied to and obtained from the Commission[3] a Certificate of Public Convenience and Necessity to construct approximately 58 miles of new water mains and other distribution facilities. In its application, Judy Water expressly advised the Commission that it "has a preliminary agreement to purchase its total potable water supply from the City of North Middletown to serve this project at an estimated water price of $1.90 to $2.00 per 1000 gallons."[4]

In December 2001, North Middletown began providing water service to Judy Water at a rate of $2.14 per 1,000 gallons. This rate reflected an increase in the cost of water that North Middletown purchased from KAWC.[5]

On June 26, 2003, Judy Water applied to the Commission for a rate adjustment based upon its operations for the calendar year ending December 31, 2002.[6] Commission Staff assisted in the preparation of this application and conducted a limited review of Judy Water's financial records.[7] A review of these financial records should have indicated that Judy Water was purchasing a portion of its water requirements from North Middletown.[8] The Commission accepted Commission Staff's findings and

---

[3] Case No. 2000-00161, The Application of Judy Water Association of Montgomery County, Kentucky, For Order Approving Construction, Financing, and Certificate of Public Convenience and Necessity and Water Rates for Federally Funded Construction Projects (Ky. PSC June 30, 2003).

[4] Meridian Engineers and Land Surveyors, Inc., "Preliminary Engineering Report For Rural Water Extensions into Bourbon County, Kentucky" at 6 (Aug. 1997) found in Judy Water Association's Application at Exhibit 8.

[5] Case No. 2000-00120, Application of Kentucky-American Water Company to Increase Its Rates (Ky. PSC May 9, 2001).

[6] Case No. 2003-00249, Application For an Adjustment of Rates of Judy Water Association, Inc. (Ky .PSC Sep. 9, 2003).

[7] Case No. 2003-00249, "Staff Report on Judy Water Association" at 1 (Aug. 20, 2003).

[8] In support of its application, Judy Water Association submitted its Financial Statements and Independent Auditor Report for the years ending December 31, 2001 and December 31, 2002. In its notes, Judy Water Association specifically notes that "[t]he Association purchases water from Mt. Sterling Water and Sewer System and City of North Middletown."

recommendations without any comment on Judy Water's water purchase contract with North Middletown.

In March 2004, Judy Water obtained a Certificate of Public Convenience and Necessity to construct approximately 398 miles of new water mains and other distribution facilities.[9] In its application, Judy Water expressly advised the Commission that "Judy Water Association purchases water from Mount Sterling Water System and North Middletown Water System [sic]."[10]

In January 2005, North Middletown again increased its rate to Judy Water to reflect an increase from KAWC.[11] North Middletown currently provides water service to Judy Water at a monthly rate of $2.33 per 1,000 gallons for the first 2,000,000 gallons and at $2.65 per 1,000 gallons for all purchases in excess of 2,000,000 gallons.

On November 29, 2005, Judy Water applied to the Commission for adjustment in its rates for water service to reflect increases in the wholesale rates of its suppliers.[12] In support of its application, Judy Water stated that North Middletown had increased its wholesale water service rate in January 2004. Because the Commission's records failed to reflect that North Middletown had filed any rate schedule to reflect its current wholesale service rate or its wholesale rate prior to January 1, 2004, Commission Staff contacted officials of North Middletown and Judy Water regarding North Middletown's

---

[9] Case No. 2004-00039, Application of Judy Water Association, Inc. For a Certificate of Public Convenience and Necessity for a Water System Improvements Project for Bourbon, Clark and Montgomery Counties, Kentucky (Ky. PSC Mar. 24, 2004).

[10] Strand Associates, Inc., "Final Engineering Report for Judy Water Association: Water System Improvements for Bourbon, Clark and Montgomery Counties, Kentucky" at 2-1 (Dec. 2003).

[11] Case No. 2004-00103, Adjustment of Rates of Kentucky-American Water Company (Ky. PSC Feb. 28, 2005).

[12] Case No. 2005-00480, Purchased Water Adjustment of Judy Water Association (Ky. PSC Dec. 21, 2005).

provision of water service to Judy Water. North Middletown officials acknowledged that the city was providing wholesale water service to Judy Water and that neither the contract nor the subsequent revisions to the contract had been filed with the Commission.

At no time prior to March 2006 did North Middletown file with the Commission a copy of its contract with Judy Water or any schedule of rates that reflect its current rates.

DISCUSSION

KRS 278.010(3) effectively exempts facilities owned, controlled, operated, or managed by a "city" from Commission regulation by excluding such municipal utilities from the definition of a public utility.[13] In Simpson County Water District v. City of Franklin, 872 S.W.2d 460 (Ky. 1994), however, the Kentucky Supreme Court held this exemption did not extend to contracts for utility service between a municipal utility and a public utility. The Court ruled that "where contracts have been executed between a utility and a city . . ., KRS 278.200 is applicable and requires that by so contracting the [c]ity relinquishes the exemption and is rendered subject to . . . [Commission] rates and service regulation." [14]

KRS 278.200 provides:

> The commission may, under the provisions of this chapter, originate, establish, change, promulgate and enforce any rate or service standard of any utility that has been or may be fixed by any contract, franchise or agreement between the utility and any city, and all rights, privileges and obligations arising out of any such contract, franchise or agreement, regulating any such rate or service standard, shall be subject to the jurisdiction and supervision of the

[13] See McClellan v. Louisville Water Company, 351 S.W.2d 197 (Ky. 1961).

[14] 872 S.W.2d at 463.

> commission, but no such rate or service standard shall be changed, nor any contract, franchise or agreement affecting it abrogated or changed, until a hearing has been had before the commission in the manner prescribed in this chapter [emphasis added].

Simpson County effectively subjects all contracts between municipal utilities and public utilities to the Commission's jurisdiction, requires all municipal utility transactions with a public utility to comply with the provisions of KRS Chapter 278, and makes Commission approval a prerequisite to any change in a rate that a municipal utility assesses a public utility for wholesale utility service.

Pursuant to the Simpson County decision, the Commission in Administrative Case No. 351 directed that all municipal utilities that provide wholesale utility service to a public utility "file with the Commission a copy of their contracts with the public utility and a schedule of their rates for wholesale service."[15] It further directed that "[a]ny municipal utility wishing to change or revise a contract or rate for wholesale utility service to a public utility shall, no later than 30 days prior to the effective date of the revision, file with the Commission the revised contract and rate schedule."[16] KRS 278.160(1) and (2) and KRS 278.180(1) supported and required this directive.

KRS 278.160 provides:

> (1) Under rules prescribed by the commission, each utility shall file with the commission, within such time and in such form as the commission designates, schedules showing all rates and conditions for service established by it and collected or enforced. The utility shall keep copies of its schedules open to public inspection under such rules as the commission prescribes.

---

[15] Id. at 1 – 2.

[16] Id. at 2.

> (2) No utility shall charge, demand, collect, or receive from any person a greater or less compensation for any service rendered or to be rendered than that prescribed in its filed schedules, and no person shall receive any service from any utility for a compensation greater or less than that prescribed in such schedules.

KRS 278.180(1) provides in pertinent part:

> [N]o change shall be made by any utility in any rate except upon thirty (30) days' notice to the commission, stating plainly the changes proposed to be made and the time when the changed rates will go into effect. However, the commission may, in its discretion, based upon a showing of good cause in any case, shorten the notice period from thirty (30) days to a period of not less than twenty (20) days. The commission may order a rate change only after giving an identical notice to the utility. The commission may order the utility to give notice of its proposed rate increase to that utility's customers in the manner set forth in its regulations.

North Middletown has stipulated that, prior to March 30, 2006, it had not filed with the Commission a copy of its contract with Judy Water or any rate schedule that reflected the rates established in the contract. This failure constitutes a violation of KRS 278.160(1) and the Commission's Order of August 10, 1994 in Administrative Case No. 351.

North Middletown has also stipulated that it twice increased its rates for water service to Judy Water without obtaining Commission approval or providing notice to the Commission. These actions constitute a violation of KRS 278.180(1). In each

instance, North Middletown was passing through an increase in the rates of its water supplier as the water purchase contract permits.[17]

While its contract with Judy Water permits North Middletown to adjust its rates to reflect an increase in a supplier's rates, it does not relieve the utility of its legal obligation to notify the Commission of the proposed adjustment. As the contract permits, but does not require, an adjustment to reflect an increase in a supplier's rates, we do not view the contract as containing a precise rate-making formula or an automatic mechanism for passing through increases in a supplier's rates for purchased water.[18] Moreover, the contract requires compliance with the provisions of Administrative Regulation 807 KAR 5:068, which expressly mandates a filing of the adjustment with the Commission.

While not contesting that a violation of certain provisions of KRS Chapter 278 may have occurred, North Middletown asserts that these violations were not willful and occurred as a result of lack of familiarity with Commission law. It asserts that its officials assumed that references to Administrative Regulation 807 KAR 5:068 created an

---

[17] Paragraph 16 of the Water Purchase Contract provides:

> Seller shall be allowed to "pass through" to Purchaser, all increases in price from its supplier, Kentucky American Water Company, and the parties agree that the provisions of 807 KAR 5:068, as now or may be in effect, (and if repealed, the most recent regulation governing the subject matter, unless replaced by another regulatory scheme, which shall then apply) "Purchased Water Adjustment for Water Districts and Water Associations" shall apply to this clause of this Agreement, and that Seller and any successor as set forth herein shall be determined to be determined to be, for purposes of that regulation, the Water District or Water Association as set forth therein.

[18] Were the water purchase contract to contain such formula, we would not consider North Middletown's application of this formula to reflect changes in its supplier's rates to constitute a rate adjustment and would not be considered a violation of KRS 278.160 or 278.180. See Re Lynchburg Gas Company, 6 PUR3d 33, 37 (Va.SCC 1954) ("A charge that can be computed by a fixed mathematical formula is as firmly fixed as a charge that is stated in terms of money.")

automatic adjustment clause that did not require any filing with the Commission. It further asserts that North Middletown was unaware of the need for any filing until the issuance of the Commission's Order of February 24, 2006.

The Commission finds that, even assuming that the contract permitted an automatic pass-through, the process set forth in Administrative Regulation 807 KAR 5:068 nonetheless required notice to the Commission. North Middletown failed to comply with notice requirements of that regulation.

KRS 278.990(1)[19] requires the assessment of a penalty for each offense. In determining the amount of this penalty, the Commission has considered the appropriateness of the penalty to the size of North Middletown's operations, North Middletown's familiarity with KRS Chapter 278, the gravity of its violations, and its efforts to comply with KRS Chapter 278 following the initiation of this proceeding. We find that North Middletown should be assessed a penalty of $50 for each violation or a total penalty of $150.

---

[19] Any officer, agent, or employee of a utility, as defined in KRS 278.010, and any other person who willfully violates any of the provisions of this chapter or any regulation promulgated pursuant to this chapter, or fails to obey any order of the commission from which all rights of appeal have been exhausted, or who procures, aids, or abets a violation by any utility, shall be subject to either a civil penalty to be assessed by the commission not to exceed two thousand five hundred dollars ($2,500) for each offense or a criminal penalty of imprisonment for not more than six (6) months, or both. If any utility willfully violates any of the provisions of this chapter or any regulation promulgated pursuant to this chapter, or does any act therein prohibited, or fails to perform any duty imposed upon it under those sections for which no penalty has been provided by law, or fails to obey any order of the commission from which all rights of appeal have been exhausted, the utility shall be subject to a civil penalty to be assessed by the commission for each offense not less than twenty-five dollars ($25) nor more than two thousand five hundred dollars ($2,500). Each act, omission, or failure by an officer, agent, or other person acting for or employed by a utility and acting within the scope of his employment shall be deemed to be the act, omission, or failure of the utility.

The Commission further finds that North Middletown should not be required to refund any monies collected in excess of the original contract rate. Refunding would result in a significant windfall for Judy Water. (Judy Water, moreover, has not disputed the reasonableness of the charges that North Middletown assessed.) Moreover, the holding of Kentucky Public Service Commission v. Cumberland Falls Highway Water District, 834 S.W.2d 726 (Ky. App. 1992), would appear to permit North Middletown to recover any refunded amounts in the form of a separate surcharge. The refund, therefore, would not have any practical effect on either the municipal utility or its wholesale customer.

SUMMARY

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

1. In October 1999, North Middletown and Judy Water executed a water purchase contract for North Middletown to sell water to Judy Water at a rate of $1.95 per 1,000 gallons.

2. Pursuant to the Simpson County decision, the rates and service provision of this water purchase agreement were subject to Commission jurisdiction. KRS 278.160 further required North Middletown to file this water purchase agreement with the Commission.

3. North Middletown violated KRS 278.160 by failing to file a copy of the water purchase contract with the Commission.

4. In December 2001, North Middletown began providing water service to Judy Water at a rate of $2.14 per 1,000 gallons.

5. At the time North Middletown began providing water service to Judy Water, it had not filed a copy of its water purchase agreement with the Commission or tariff sheets that reflected either the rate of $1.95 per 1,000 gallons of water set forth in the water purchase agreement or the rate of $2.14 per 1,000 gallons.

6. North Middletown violated KRS 278.160 and KRS 278.180 by failing to give notice to the Commission of its rate adjustment and by failing to file with the Commission a rate schedule reflecting the rate of $2.14 per 1,000 gallons.

7. In January 2005, North Middletown increased its rate to Judy Water to reflect an increase from its wholesale supplier. When increasing its rate for wholesale water service, it failed to file with the Commission a revised rate schedule that reflected a monthly rate of $2.33 per 1,000 gallons for the first 2,000,000 and $2.65 per 1,000 gallons for all purchases in excess of 2,000,000 gallons.

8. North Middletown violated KRS 278.160 and KRS 278.180 by failing to give notice to the Commission of its rate adjustment and by failing to file with the Commission a rate schedule reflecting a monthly rate of $2.33 per 1,000 gallons for the first 2,000,000 and $2.65 per 1,000 gallons for all purchases in excess of 2,000,000 gallons.

9. North Middletown should be assessed a penalty of One Hundred Fifty Dollars ($150) for its willful violations of KRS 278.160 and 278.180.

IT IS THEREFORE ORDERED that:

1. North Middletown is assessed a penalty of One Hundred Fifty Dollars ($150) for its willful violations of KRS 278.160 and 278.180.

2. Within 30 days of the date of this Order, North Middletown shall pay its assessed penalties to the Commonwealth of Kentucky. Payment shall be in the form

of a cashier's check made payable to "Treasurer, Commonwealth of Kentucky" and shall be mailed or delivered to the Office of General Counsel, Public Service Commission of Kentucky, 211 Sower Boulevard, Post Office Box 615, Frankfort, Kentucky 40602.

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

Done at Frankfort, Kentucky, this 12th day of January, 2007.

By the Commission

ATTEST:

Executive Director