

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

* * * * *

In the Matter of:

THE PROPOSED MERGER OF THE HENRY)
COUNTY WATER DISTRICT AND THE) CASE NO. 9327
HENRY COUNTY WATER DISTRICT NO. 2)

O R D E R

On April 30, 1985, the Commission upon its own motion initiated an investigation into the advisability of a merger of the Henry County Water District and the Henry County Water District No. 2. Pursuant to KRS 74.361(2), the Commission has prepared a feasibility report regarding a merger (Appendix A).

The Commission, having considered the report and being advised, is of the opinion and finds that it may propose that a merger of the Henry County Water District and the Henry County Water District No. 2 be accomplished.

IT IS THEREFORE ORDERED that:

(1) This matter be and it hereby is set for hearing on November 26, 1985, at 9:00 a.m., Eastern Standard Time, in the Commission's offices at Frankfort, Kentucky, for the purpose of considering the proposed merger.

(2) That each district shall file written comments on the feasibility report by November 15, 1985.

Done at Frankfort, Kentucky, this 31st day of October, 1985.

ATTEST:

PUBLIC SERVICE COMMISSION

Secretary

Richard D. Hemann, Jr.

For the Commission

APPENDIX "A"

R E P O R T

TO: The Commission

THRU: Claude G. Rhorer, Jr., Director
Division of Engineering and Services *BBT for CGR, Jr.*

FROM: Eddie B. Smith, Public Service Engineer
Water and Sewage Section *Eddie B. Smith*

RE: The proposed merger of the Henry County Water
District and Henry County Water District No. 2
C.N. 9327

DATE: October 15, 1985

INTRODUCTION

The 1972 General Assembly adopted KRS 74.361 which states "the general assembly of the Commonwealth of Kentucky determines as a legislative finding of fact that the reduction of the number of operating water districts in the Commonwealth will be in the public interest." The Public Service Commission is, by KRS 74.361, "authorized and empowered to initiate, carry out, and complete such investigations, inquiries, and studies as may be reasonably necessary to determine the advisability as to the merger of water districts." The statute further outlines the procedure to be followed in order to accomplish the merger of water districts (and water associations) by the Public Service Commission. A merger proposed by the Public Service Commission is required to be based on a written report and study. In

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addition, a formal hearing before the Public Service Commission must be held on the subject of such proposed merger. At the conclusion of such proceedings the Commission enters an Order, either merging the water districts into a single district, or abandoning the merger proposal.

On April 30, 1984, the Public Service Commission, upon its own motion and pursuant to KRS 74.361, entered an Order initiating an investigation to determine the advisability as to the merger of the Henry County Water District and the Henry County Water District No. 2. This report is the initial step required by KRS 74.361.

DISTRICTS BEING CONSIDERED

Henry County Water District

The Henry County Water District was established on April 11, 1953, by the Henry County Court in accordance with the provisions of KRS Chapter 74. On October 29, 1958, the District was extended into Shelby County by an order of the Shelby County Court. Additional area in Henry County was annexed to the District by a Henry County Court order of June 27, 1967. Henry County Water District's current service area contains approximately 58 square miles in the south central section of Henry County and the northeastern part of Shelby County (see Figure 1).

In 1954 the District applied for and received a Certificate of Public Convenience and Necessity for construction of a water distribution system and filtration plant (C.N. 2836). The District was unable to act on this initial Certificate and reapplied in 1958 (C.N. 3510). The District began construction in 1958 and began actual operation in 1959. The initial project provided water service to approximately 235 customers in the City of Pleasureville and was financed by a 4 1/2 percent \$214,000 40-year bond issue. The U. S. Housing and Home Finance Agency purchased \$175,000 of these bonds with \$29,000 being purchased by private investors. In 1966 the District applied for and received a certificate for construction of extensions to its water distribution system (C.N. 4749). The 1967 project extended water service to approximately 175 additional customers in the rural areas of Henry and Shelby counties near Bethlehem, Defoe, Cropper, and Elmburg. This project was financed by a \$439,000 bond issue purchased by the U. S. Department of Housing and Urban Development. Included in this issue was the refunding of the \$195,000 in outstanding bonds of the 1958 issue at 4 1/2 percent as Series A bonds and the new issue of Series B bonds in the amount of \$244,000 at 4 percent for a 36-year period. The District has not made any substantial extensions to its distribution system since the

1967 construction. In 1983 the District applied for and received a certificate to construct a connection to the Henry County Water District No. 2 water system in order to obtain a dependable source of potable water. This project was financed by a loan for \$66,522.76 at 8 percent from Central Bank of Pleasureville, and a \$65,926.62 loan at 8 percent from the Deposit Bank of Pleasureville. This connection was constructed to satisfy directives from the Division of Water, NREPC. The District had been experiencing water quality problems from its water treatment plant for some time prior to this connection to District No. 2.

The Henry County Water District has generally been reluctant to extend water service even within its existing boundaries. This has led to District No. 2 constructing water lines into the northwestern corner of Henry County Water District's service area and to the North Shelby Water Company, providing water service to customers within Henry County Water District's territory near Cropper. However, the District has achieved modest customer growth on the water lines it has constructed. The number of customers has grown from the original 235 in 1959, to 375 in 1967, to 580 in 1973, and to approximately 680 at present. The District serves these customers through some 24 miles of water lines ranging from 2-inch to 8-inch in diameter (see Figure 1).

Henry County Water District No. 2

The Henry County Water District No. 2 was created by order of the Henry County Court on November 2, 1963, under the authority of KRS Chapter 74. A portion of Trimble County was annexed on July 3, 1967. Additional territory in Henry County was included by an August 29, 1967, county court order. On September 11, 1967, areas in Carroll County and Oldham County were made part of the District. District No. 2's service area boundary in Oldham County was modified by a November 19, 1984, order of the County Judge Executive. The current officially defined service area of the Henry County Water District No. 2 contains approximately 230 square miles of western Henry County, southern Trimble County and portions of adjacent Carroll and Oldham counties (see Figure 1).

In 1967 District No. 2 applied for and received a Certificate of Public Convenience and Necessity for construction of a water distribution system, wells, and water treatment facilities (C.N. 4922). This initial project provided water service to approximately 755 customers and was financed by a 4 percent \$1,850,000 39-year bond issue purchased by the Farmers Home Administration (FmHA). In 1973 District No. 2 applied for and received a certificate for construction of extensions to its water distribution

system (C.N. 5830). The 1974 construction project extended water service to approximately 200 additional customers and was financed by a FmHA grant of \$208,000 and a 5 percent \$239,000 40-year bond issue purchased by FmHA. District No. 2 obtained a certificate for construction of a 300,000-gallon water storage tank (C.N. 8043). Construction of the tank was financed by an 8 percent \$100,000 note from the United Citizens Bank and Trust Company of Campbellsburg. On August 1, 1985, District No. 2 filed its application for a certificate to construct improvements to its existing water distribution system. District No. 2 proposes to construct a 300,000-gallon water storage tank and two booster pumping stations to meet the needs of its existing customers during periods of high consumption (C.N. 9394). FmHA has offered to loan District No. 2 \$500,000 at 10 percent for a period not to exceed 40 years to finance the proposed construction.

District No. 2 has been fairly active in extending water service throughout its service area. It appears that District No. 2 has even extended water lines outside its officially defined boundaries in several locations (see Figure 1). The number of customers has grown from the original 755 in 1967, to 1079 in 1973, to 1822 in 1981, and to approximately 2036 at the present time. District No. 2 serves these customers through some 207 miles of water lines ranging from 2-inch to 12-inch in diameter (see Figure 1).

EXISTING MANAGEMENT AND OPERATIONS

Henry County Water District

The Henry County Water District is supervised by a Board of Water District Commissioners consisting of five members, three appointed by the Henry County Judge Executive, and two appointed by the Shelby County Judge Executive.

James C. Cabbage	Chairman	Henry County
L. J. Smith	Secretary	Henry County
Carl Yount	Treasurer	Shelby County
Julius Moore		Henry County
Albert Browne		Shelby County

The Board meets once a month and all matters of management and business of the District are supervised and transacted by the Commissioners. The water superintendent, Elmer J. McAlister, is in charge of the day-to-day operation of the District. The superintendent installs meters, makes repairs to the system, and does the general routine maintenance required to keep the water distribution system operating. Mr. McAlister is paid an annual salary as superintendent and is given additional compensation for actual work performed on the water distribution system. The superintendent has two assistants, Danny Maddox and Eddie Winters, who are on duty on alternate weekends. In addition

the District has a combination billing clerk and secretary who works part time.

Henry County Water District No. 2

The Henry County Water District No. 2's Board of Commissioners consists of nine members appointed by the County Judge Executives of Henry, Carroll, Trimble, and Oldham counties.

William Van Hawkins	Chairman	Henry County
Donald W. Heilman	Sec. & Treas.	Henry County
J. O. Coleman		Henry County
Merle Brewer		Carroll County
Richard R. Clark		Carroll County
Dale Jennings		Trimble County
Ray Nelson		Trimble County
G. T. Barrickman		Oldham County
Ray Moore		Oldham County

The Commissioners meet monthly to review revenues received and operation and maintenance expenses and the routine business of District No. 2. The overall daily management and maintenance of District No. 2 is the responsibility of the superintendent, Gene K. Powell. The superintendent is responsible for all equipment, materials, and labor required to maintain and repair the water distribution system. He is assisted by two office employees, two maintenance

employees, and one part-time plant operator. District No. 2 owns a machine for pushing pipe under highways, a tapping machine, a backhoe, and a trenching machine. District No. 2 maintains an inventory of materials generally necessary for repair and maintenance of its water distributing system.

CURRENT REVENUES AND EXPENSES

A 3-year comparison of the annual reports for both Henry County Water District and Henry County Water District No. 2 did not reveal any major deficiencies and are sufficiently consistent to not warrant a financial audit of either system at this time. Both Districts appear to be current in their principal and interest payments on their bonded indebtedness and in maintaining adequate cash reserves and temporary investments to meet bond ordinance requirements. The one exception noted was a \$15,000 depreciation fund requirement for the Henry County Water District. The District does report sufficient unappropriated retained earnings to fully fund this requirement.

Henry County Water District

Henry County Water District's 1984 annual report to the Commission listed total revenues of \$130,840, expenses of \$96,496 and a reported net income of \$34,344. A cash flow analysis including tap-on fees, principal and interest payments on outstanding obligations, and excluding

depreciation expense, results in a positive cash flow of \$29,166. The unadjusted operations of the District give a Debt Service Coverage (DSC) of 1.53 excluding interest income. After making the normal adjustments for a maximum line loss of 15 percent and excluding depreciation on contributed property the DSC is 1.60.

The District purchased and produced 54,026,720 gallons of water in 1984 and sold 39,346,000 gallons. The unaccounted-for water was reported to be 18.92 percent. Average sales per customer amounted to approximately 4,550 gallons per month. The District has two different tariffs for water sales to its customers, one for customers in the City of Pleasureville and another for customers outside the City.

Monthly Rates inside the City of Pleasureville

First 2,000 gallons	\$7.70 minimum bill
All over 2,000 gallons	1.70 per 1,000 gallons

Monthly Rates outside the City of Pleasureville

First 2,000 gallons	\$10.70 minimum bill
Next 3,000 gallons	2.20 per 1,000 gallons
Next 3,000 gallons	1.90 per 1,000 gallons
All over 8,000 gallons	1.70 per 1,000 gallons

Henry County Water District No. 2

Henry County Water District No. 2's 1984 annual report to the Commission listed total revenues of \$492,338, expenses of \$455,441 and a reported net income of \$36,897.

A cash flow analysis including tap-on fees, principal and interest payments on outstanding obligation, and excluding depreciation expense results in a positive cash flow of \$115,369. The unadjusted operations of District No. 2 give a DSC of 0.83 excluding interest income. After making the normal adjustments for a maximum line loss of 15 percent and excluding depreciation on contributed property, the DSC is 1.42.

District No. 2 produced 393,994,000 gallons of water in 1984 and sold 318,709,376 gallons. The unaccounted-for water was reported to be 18.60 percent. Average sales per customer amounted to approximately 7,360 gallons per month. District No. 2 has one tariff for all of its retail customers.

Monthly Rates

First 2,500 gallons	\$7.50 minimum bill
Next 2,500 gallons	2.45 per 1,000 gallons
Next 5,000 gallons	1.65 per 1,000 gallons
Next 10,000 gallons	1.10 per 1,000 gallons
All over 20,000 gallons	0.75 per 1,000 gallons

In addition, District No. 2 wholesales water to the cities of New Castle, Campbellsburg, and Eminence, to the West Carroll County Water District, the Henry County Water District, and the Kentucky Park, Inc., at \$0.75 per 1,000 gallons.

OUTSTANDING DEBT OBLIGATIONS

Henry County Water District

According to information furnished by the Henry County Water District it currently has outstanding debts totaling approximately \$411,145. The major debt instrument is a 1967 bond issue in the original amount of \$439,000 purchased by the U. S. Department of Housing and Urban Development. This issue is made up of Series A bonds in the original amount of \$195,000 at 4 1/2 percent and a final retirement date of 1998. The paying agent is the Central Bank of Pleasureville. The District is current on this series and as of April 1, 1985, the outstanding principal balance was \$110,000. The 1967 bond issue also contained Series B bonds in the original amount of \$244,000 at 4 percent and a final retirement date of 2003. The paying agent for this issue is also the Central Bank of Pleasureville. The District is current on this series and as of April 1, 1985, the outstanding principal balance was \$181,000.

The District has an unsecured note dated 1983 from the Central Bank of Pleasureville in the original amount of \$66,522.76 at 8 percent and a retirement date of 1993. On April 3, 1985, the outstanding principal amount on this loan was \$59,311 and the District was current on its payments. The District also has an unsecured note dated 1983 from the

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Deposit Bank of Pleasureville in the original amount of \$65,926.22 at 8 percent and a retirement date of 1993. On April 3, 1985, the outstanding principal amount of this loan was \$59,334 and the District was current on its payments. In addition, the District has a note with the Central Bank of Pleasureville in the original amount of \$4,251 at 8 percent. As of May 9, 1985, the District was current on this loan and the outstanding principal amount was \$1,500.

Henry County Water District No. 2

The Henry County Water District No. 2 has two bond issues, both purchased by the Farmers Home Administration, USDA. The first is a 1968 bond issue in the original amount of \$1,850,000 at 4 percent and a formal retirement date of 2007. The paying agent is United Citizens Bank, Campbellsburg, Kentucky. District No. 2 is current on this issue and as of April 1, 1985, the outstanding principal balance was \$1,410,000. District No. 2 sold its 1974 bond issue to the Farmers Home Administration in the original amount of \$239,000 at 5 percent and a final retirement date of 2014. The paying agent for this issue is also United Citizens Bank. District No. 2 is current on this issue and as of April 1, 1985, the outstanding principal balance was \$227,000. District No. 2 is presently in the process of issuing bonds for \$500,000 at 10 percent to the Farmers Home Administration to finance construction of improvements.

ANALYSIS OF MERGER FEASIBILITY

In 1972, the General Assembly of the Commonwealth of Kentucky enacted as a legislative finding of fact that the reduction of the number of operating water districts in the Commonwealth was in the public interest. The legislature further stated that the merger of such districts would tend to eliminate wasteful duplication of costs and efforts, result in a sounder and more businesslike degree of management, and would ultimately result in greater economies, less cost, and a higher degree of service to the general public. KRS 74.361 declares that the public policy favors the merger of water districts whenever feasible.

It would be unreasonable to expect that everyone will favor a merger of the two Henry County water districts. Obviously some of the people with personal or vested interests in the existing utilities will be reluctant to accept a change in status. Water utility officials, employees, engineering consultants, attorneys, accountants, and others involved with the existing utilities can be expected to view a proposed merger with suspicion. Most of these individuals will probably express public agreement with the legislative finding that merger is in the public interest. Some of them, however, may also present detailed explanations as to why such a merger should be postponed

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until some future date. In its formal response to the Commission Henry County Water District No. 2 stated its opposition to the proposed merger. Among District No. 2's objections were its belief that the merger would not reduce personnel, would increase travel expense, require the maintenance of two sets of records, and would complicate the proper allocation of expenses. In addition, District No. 2 stated that because of its involvement with a current construction project a merger "within the near future" would overload District No. 2's personnel.

The Henry County Water District, in its response to the Commission, expressed the belief that the merger of the two districts would result in more efficient operations. Central to its position is the fact that the District's water treatment plant has been condemned by the Division of Water and that Henry County Water District No. 2 is now supplying all of the District's water. Henry County Water District also stated that the name of the merged districts should be changed to better reflect its broad service area.

The most critical issue involved in the successful merger of the two districts will be the assignment or transfer of the various debt instruments. The holders of the major debts of both districts are federal agencies, the Farmers Home Administration (FmHA) and the U. S. Department of Housing and Urban Development (HUD).

A meeting with representatives of these two agencies was held on August 7, 1985, to discuss the steps necessary to accommodate the outstanding debts of both districts in a merged water district. At that meeting it was generally agreed that bond counsel should be retained and that bond counsel should establish a timetable for the merger. HUD stated that it will not require its own bond counsel. FmHA indicated the bond counsel retained by the Henry County Water District No. 2 for its proposed construction project could be utilized for the merger opinion.

Although the precise means by which merger of the two districts could be accomplished would depend upon the recommendations of bond counsel, one method discussed was a bond exchange. Under this method, HUD would essentially accept bonds of the merged district in exchange for the bonds it currently holds on the Henry County Water District. HUD indicated that it has approved similar transfers in the past. FmHA indicated that it would prefer that the unsecured notes the Henry County Water District has with local banks be refinanced by a bond issue. FmHA indicated that it may be able to refinance these notes with funds available through its agency.

FmHA suggested that the transfer and assignment of the debts could be facilitated by Henry County Water

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District No. 2 amending its current construction application to include the refinancing of the debts of the merged water district.

CONCLUSIONS AND RECOMMENDATIONS

This report concludes, as did the General Assembly in 1972, that the merger of water districts is in the public interest. It is also determined that it is feasible and advisable to merge the Henry County Water District into the Henry County Water District No. 2.

It is anticipated that there will be some opposition to merger including a request from some parties that merger be delayed until a future date. This has occurred in past cases. Nevertheless, this report concludes that the two districts should be merged at this time.

This report should be entered into the record in this matter to meet the requirements of KRS 74.361 for a written report and study of those mergers proposed by this Commission. A formal hearing on the proposed merger should be held as soon as possible.

EBS:mfb

