

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

PROPOSED ADJUSTMENT TO THE WHOLESALE )  
WATER RATES OF THE CITY OF CYNTHIANA, ) CASE NO. 99-300  
KENTUCKY )

ORDER

The City of Cynthiana, Kentucky (“Cynthiana”) and Harrison County Water Association (“HCWA”) have moved for approval of a Settlement Agreement in this matter. Having carefully reviewed this Agreement, the Commission finds that it should be approved subject to certain modifications.

On July 22, 1999, Cynthiana filed with the Commission a revised rate schedule for its wholesale water service to HCWA. It proposed to eliminate from its existing rate schedule its lowest rate block and to charge a monthly rate for \$1.61 per 1,000 gallons for all water purchases in excess of 100,000 gallons. Currently, Cynthiana charges a rate of \$1.27 per 1,000 gallons for all water purchases in excess of 500,000 gallons.<sup>1</sup> Upon HCWA’s objection and request for investigation, the Commission suspended the proposed rate revision and initiated this proceeding. During this proceeding, Cynthiana made several amendments to its proposed wholesale rate schedule. It ultimately

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<sup>1</sup> Cynthiana’s current wholesale rate schedule is:

First 2,000 gallons	\$8.05 per 1,000 gallons
Next 8,000 gallons	\$3.05 per 1,000 gallons
Next 490,000 gallons	\$1.61 per 1,000 gallons
Over 500,000 gallons	\$1.27 per 1,000 gallons

proposed to replace its declining block rate schedule with a wholesale rate of \$2.15 per 1,000 gallons.

On March 20, 2000, Cynthiana and HCWA submitted for Commission approval an agreement on the rates for wholesale water service. The principal terms of this Agreement, a copy of which is appended hereto, are:

1. Cynthiana may, effective March 1, 2000, assess a rate of \$1.85 per 1,000 gallons for wholesale water service to HCWA.

2. Within seven days of Commission approval of the Agreement, HCWA shall pay to Cynthiana the sum of \$35,481.60 for its proportional share of costs incurred by Cynthiana and related to the 1999 Drought.

3. Each party waives any claim to reimbursement or recovery of its expenses incurred in connection with the proceeding.

4. Cynthiana may assess HCWA for "incremental and identifiable increase[s] in the cost of water" that result from "an extraordinary condition." This assessment shall be determined by multiplying the costs related to the extraordinary condition by the ratio of HCWA's water purchases to Cynthiana's total water production for the 12 months immediately preceding the condition. Any disputes regarding this assessment may be submitted to the Commission for resolution. During the pendency of any disputed assessment, interest shall accrue on the assessment at a rate of 8 percent per annum.

The parties have further agreed that the Agreement will not become effective unless the Commission approves it in its entirety.

After careful review of the Agreement and the evidence of record, the Commission finds that, with two exceptions, the Agreement's provisions are reasonable and lawful and should be approved. We find that the proposed wholesale water service rate is within the zone of reasonableness. We further find that the proposed payment of \$35,481.60 for extraordinary drought expenses represents an acceptable means of

recovering those expenses in lieu of a temporary rate surcharge or their inclusion in general rates.

However, the Commission finds that the Agreement's provision for retroactive application of the proposed wholesale rate violates the rule against retroactive rate-making and is therefore unlawful. KRS Chapter 278 does not authorize the Commission to establish rates retroactively. See Pub. Serv. Comm'n v. Diamond State Tele. Co., 468 A.2d 1285, 1298 ("A pervasive and fundamental rule underlying the utility rate-making process is that 'rates are exclusively prospective in application. . . .'" (Del. 1983).

The Commission further finds the Agreement's provision for the assessment of extraordinary costs in its current form is unreasonably vague. The parties fail to define key terms in their proposal such as "extraordinary condition" and "cost of water produced." They fail to state whether the costs that will passthrough this mechanism include amounts expended for capital expenditures. They fail to explain how a cost will be determined to represent "an incremental and identifiable increase." They have not established any base period against which to measure or assess such costs. Finally, the parties have not addressed how HCWA is to pay the assessment. If capital expenditures are recoverable under the mechanism, for example, will HCWA be required to pay its portion in a lump sum payment or over the service life of the capital equipment?

The Commission empathizes with the parties' desire for an orderly and systematic method of adjusting rates to reflect significant changes in the cost of water. We find much merit in the use of automatic adjustment mechanisms that would adjust a water utility's base rates to reflect changes in the cost of water production. The parties'

proposal, however, is not likely to achieve this result. Its vague terms are more likely to result in litigation.

While rejecting this provision, the Commission encourages the parties to develop a more detailed mechanism for submission. Such a mechanism should consider the issues raised in this Order and should also consider how HCWA would recover from its ratepayers any assessment of costs that Cynthiana makes. When designing such mechanism, the parties should consider whether any assessment by Cynthiana may be recovered by HCWA through its purchased water recovery mechanism. We further encourage Cynthiana to request an informal conference with Commission Staff to discuss the design and operation of any proposed recovery mechanism.

IT IS THEREFORE ORDERED that:

1. The Settlement Agreement, as modified in Ordering Paragraphs 2 and 3 below, is approved.
2. The rate of \$1.85 per 1,000 gallons is approved for water service that Cynthiana provides to HCWA on and after the date of this Order.
3. The proposed mechanism for the immediate passthrough of costs related to extraordinary conditions, which is set forth in Paragraph 9 of the Settlement Agreement, is denied.
4. Within 20 days of the date of this Order, Cynthiana shall file tariff sheets that reflect the rate approved herein.
5. If either party wishes to withdraw from the Settlement Agreement because of the modifications ordered herein, it shall notify the Commission in writing within 7 days of the date of this Order.

6. If either party withdraws from the Settlement Agreement, Ordering Paragraphs 1 through 4 of this Order shall be vacated upon the Commission's receipt of the party's notice of withdrawal and the parties shall appear before the Commission on May 4, 2000 at 9:00 a.m., Eastern Daylight Time, in Hearing Room 2 of the Commission's offices at 211 Sower Boulevard, Frankfort, Kentucky for the purpose of hearing evidence on Cynthiana's proposed rate revision.

Done at Frankfort, Kentucky, this 24<sup>th</sup> day of April, 2000.

By the Commission

ATTEST:

  
Executive Director

APPENDIX

AN APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 1999-300 DATED APRIL 24, 2000

**SETTLEMENT AGREEMENT**

THIS SETTLEMENT AGREEMENT made and entered into this 16<sup>th</sup> day of March, 2000, by and between the City of Cynthiana ("Cynthiana") and the Harrison County Water Association ("HCWA");

WITNESSETH:

THAT, WHEREAS, Cynthiana and the HCWA are currently parties to a Water Purchase Contract dated October 21, 1987, under which Cynthiana is obligated to sell water to the HCWA at certain rates; and

WHEREAS, as a result of the Kentucky Supreme Court case in Simpson County Water District v. City of Franklin, Ky., 872 S.W.2d 460 (1994), the water rates charged by city municipalities under contracts with regulated water utilities were found to be subject to the jurisdiction and approval of the Kentucky Public Service Commission ("PSC") and Chapter 278 of the Kentucky Revised Statutes; and

WHEREAS, in June of 1999, Cynthiana filed with the PSC a proposed increase in its water rate to HCWA; and

WHEREAS, HCWA requested that the PSC suspend and investigate Cynthiana's proposed rate adjustment and intervened in the proceedings, docketed as PSC Case No. 99-300; and

WHEREAS, the parties hereto, having participated in the administrative rate proceeding in Case No. 99-300, being desirous of settling their water rate dispute without further administrative litigation;

NOW, THEREFORE, in complete and full settlement of the issues raised in Case No. 99-300, styled "In the Matter of: Proposed Adjustment of the Wholesale Water Service Rates of the City of Cynthiana, Kentucky," the parties stipulate and agree as follows:

- (1) Cynthiana shall establish and charge HCWA for all water purchased by HCWA the rate of \$1.85 per 1,000 gallons.
- (2) The effective date of the water rate of \$1.85 referred to in Paragraph 1 above shall be March 1, 2000.
- (3) HCWA shall further pay to Cynthiana in a lump sum \$35,481.60, said amount being HCWA's proportionate share (45%) of the costs incurred by Cynthiana associated with the drought of 1999. This amount shall be paid within seven (7) days of the PSC's approval of this Settlement Agreement.
- (4) This Settlement Agreement shall be submitted to the PSC for approval, which approval shall be sought on an expedited basis by both parties. In the event the PSC does not approve the Settlement Agreement, including the March 1<sup>st</sup> effective date for the implementation of the new wholesale rate of \$1.85 per 1,000 gallons, this Settlement Agreement shall be null and void and of no effect.
- (5) Cynthiana shall not seek further recovery or rate relief for any expenses or costs incurred by Cynthiana in connection with Case No. 99-300, the rate proceeding to be concluded by this Settlement Agreement; nor shall HCWA seek recovery of their costs from Cynthiana.
- (6) In the future, HCWA shall not raise, assert or rely on the rate provisions contained in the Water Purchase Contract; which contract provisions shall be deemed to have been superseded by the PSC's regulatory authority over rates charged by non-regulated utilities to regulated utilities.



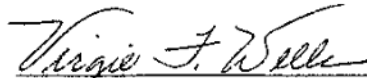
(7) Cynthiana shall and does hereby release HCWA from any claims under the Water Purchase Contract with reference to HCWA's water rates, the terms and agreements contained herein constituting full satisfaction of such claims.

(8) HCWA shall and does hereby release Cynthiana from any claims under the Water Purchase Contract with reference to HCWA's water rates, the terms and agreements contained herein constituting full satisfaction of such claims.

(9) HCWA agrees that, in the future, should an extraordinary condition (e.g., drought, floods, regulatory changes) cause an incremental and identifiable increase in the cost of water produced by Cynthiana for supply to Cynthiana retail customers, as well as to HCWA, HCWA shall reimburse Cynthiana for such costs within sixty (60) days after submission by Cynthiana, of an itemization of the costs incurred. The reimbursement shall be calculated by multiplying the amount of the submitted emergency costs times a fraction, the numerator of which is the wholesale water purchases by HCWA in the most recent 12 month period preceding the emergency, and the denominator of which shall be the total water production for the Cynthiana plant over the same period. Any disputes over the amount to be paid by HCWA, or the manner of such payment, shall be submitted to the PSC for resolution; provided that any payment ultimately made by HCWA shall include interest at eight percent (8%) per annum commencing after sixty (60) days following submission of the emergency costs to HCWA by Cynthiana.

(10) This Settlement Agreement has been duly executed by the lawful representatives of the City of Cynthiana and the HCWA, after full disclosure of the terms hereof, after consultation with counsel, and after appropriate resolution and/or ordinance approving the Settlement Agreement by the City Commission of the City of Cynthiana and the Board of the HCWA respectively.

CITY OF CYNTHIANA

  
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Virgie F. Wells, Mayor

HARRISON COUNTY WATER ASSOCIATION, INC.

  
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William R. Toadvine, President

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