

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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|--------------------------------------|---|----------|
| THE JOINT APPLICATION OF THE SPEARS |) | |
| WATER COMPANY, INC. AND THE CITY OF |) | |
| NICHOLASVILLE FOR APPROVAL OF AN |) | |
| ASSET PURCHASE AGREEMENT WHEREBY |) | |
| THE CITY OF NICHOLASVILLE PROPOSES |) | CASE NO. |
| TO ACQUIRE THE EXISTING WATER |) | 2001-325 |
| DISTRIBUTION SYSTEM OF THE SPEARS |) | |
| WATER COMPANY, INC. PURSUANT TO |) | |
| THE PROVISIONS OF KRS 278.020(4) AND |) | |
| 807 KAR 5:001(8) |) | |

O R D E R

On October 4, 2001, Spears Water Company, Inc. (Spears Water) and the city of Nicholasville (Nicholasville) submitted a joint application for Commission approval for the transfer of the water utility owned and operated by Spears Water to Nicholasville. There were no deficiencies in the application and it was considered filed the date it was submitted. However, on January 4, 2002, by agreement of the parties, including the intervenors hereinafter identified, the date for Commission approval of the transfer was extended to March 15, 2002.

On October 22, 2001, the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention, pursuant to his motion, was permitted to intervene as a party to these proceedings. On November 6, 2001, Kentucky-American Water Company, pursuant to its motion, was likewise permitted to intervene as a party to these proceedings, but on February 20, 2002 was permitted to withdraw. None of the remaining parties prefiled testimony and, in accordance with the procedural Order entered in these proceedings on January 14, 2002, the matter is before the Commission

on the existing record. Having reviewed the record, the Commission makes the following Findings of Fact, Conclusions of Law and Order.

FINDINGS OF FACT

1. Spears Water is a corporation, organized and existing under the laws of this state, whose corporate office is at 104 West Maple Street, Nicholasville, Kentucky. Spears Water owns a water utility operating under the jurisdiction of this Commission that serves approximately 2,900 customers in Jessamine and Fayette counties.

2. Nicholasville is a third-class city organized and existing under the laws of this state, whose principal office is at 601 North Main Street, Nicholasville, Kentucky.

3. Nicholasville owns water treatment, supply and distribution facilities, electric distribution facilities, and sanitary sewer facilities, which are operated as a combined and consolidated municipal utilities system. Nicholasville currently serves approximately 7,000 water customers.

4. To manage and operate its water system, Nicholasville employs eight licensed operators, each of whom has been certified by the Kentucky Board of Certification of Water Treatment and Distribution System Operators.

5. According to Nicholasville's audited financial statements for the fiscal year ending June 30, 2000, its Combined Utilities Fund had assets of \$42,098,508, liabilities of \$23,099,479, and total fund equity of \$18,999,029. For the same period, Nicholasville's Combined Utilities Fund recorded operating revenues of \$10,829,862 and operating expenses of \$9,683,670, resulting in net utility operating income of \$1,146,192.

6. According to its 2000 Annual Report, Spears Water had assets of \$1,881,350 and total liabilities of \$563,101. For the same period it had operating revenues of \$1,012,375 and operating expenses of \$1,033,543, resulting in a net operating loss of \$21,168.

7. Spears Water purchases the water it distributes to its customers from Nicholasville and Kentucky-American Water Company.

8. The application arises out of an Asset Purchase Agreement executed by the applicants on July 26, 2001.¹ Under the terms of the agreement, Spears Water agreed to sell to Nicholasville certain assets, including Spears Water's water distribution system, for \$4,250,000. As additional consideration, Nicholasville agreed to charge the current Spears Water customers, and future customers in Spears Water's service area, the same rates they are now paying. Nicholasville also agreed not to increase those rates until the water rates of Nicholasville's current customers of equivalent classification rise to the level of Spears Water's rates, which Nicholasville estimates will take at least 10 years.

9. Nicholasville is not assuming any liabilities of Spears Water; however, Spears Water shall transfer to Nicholasville a sum of money equal to the principal amount of customer deposits held by Spears Water at the time of closing. After closing, Nicholasville will be responsible for refunding customer deposits and paying interest on

¹ William M. Arvin is the owner of 50 percent of Spears Water's common stock and is also the Nicholasville City Attorney. In response to Item 1(b) of the Attorney General's Request for Information, Nicholasville stated that because of this conflict, Mr. Arvin recused himself from representing the city in this matter.

the deposits. The final bill rendered by Spears Water will credit accrued interest owed on customer deposits.

10. In its 2000 annual report, Spears Water reported net book value of utility plant of \$1,763,026 (\$2,825,021 gross plant less accumulated depreciation of \$1,061,995) and net contributions in aid of construction of \$1,322,015 for a net unrecovered value of utility plant of \$441,011. Both the net book value of plant and the net unrecovered value are far less than the purchase price. Nevertheless, in paragraph 20 of its application, Nicholasville stated that it has the ability to provide service to Spears Water's customers without causing a financial burden on Spears or the City's existing customers or adversely affecting the quality of service presently afforded the existing customers of Spears or the City. Supporting that allegation is a cash flow analysis provided by Nicholasville that was performed by Black & Veatch based upon Spears Water's 1998 rates. Using a 6 percent discount rate, Black & Veatch estimated that, for the 20-year period beginning in 2000, the assets purchased by Nicholasville from Spears Water would produce discounted cash flows of \$6,858,535. Therefore, the discounted cash flows should be sufficient to cover the cost of the acquisition of Spears Water.

11. Combining and consolidating the Spears Water distribution system with the Nicholasville water system should result in economies of scale and should allow the combined system to be operated, managed and maintained more efficiently.

CONCLUSIONS OF LAW

1. Nicholasville has the financial, technical and managerial abilities to provide reasonable service to the customers of Spears Water, and the transfer is for a proper purpose.

2. The transfer serves the public interest by absorbing a small water system into a larger professionally operated system thereby better ensuring Spears Water customers of receiving reliable and efficient service at fair, just and reasonable rates.

3. In accordance with the assertion by Nicholasville that it has the ability to provide service to Spears Water's customers without causing them a financial burden, the transfer should be approved subject to the following conditions, which Nicholasville should be required to specifically accept in writing within 10 days of the date of this Order:

a. No portion of the rates charged to Spears Water's existing customers and to future customers in the area now served by Spears Water shall be used to recover the difference between the purchase price for the Spears Water system and the net unrecovered value of the system at the time of transfer.

b. Nicholasville shall keep a record of the original cost, accumulated depreciation, contributions in aid of construction, and accumulated amortization of contributions in aid of construction at the time of purchase for those assets it is purchasing from Spears Water.

c. Nicholasville shall notify the Commission of any future sale or transfer to a regulated utility of some or all of those assets purchased from Spears Water.

This Commission being otherwise sufficiently advised, IT IS HEREBY ORDERED that:

1. The proposed transfer of the water system of Spears Water to Nicholasville is in the public interest and is hereby approved, subject to the conditions set forth in paragraph 3 of the Conclusions above.

2. The proposed transfer shall not be made unless and until Nicholasville files with the Commission, within 10 days of the date of this Order, a statement from a duly authorized representative, that it accepts, and will fully comply with, the conditions set forth in paragraph 3 of the Conclusions above.

Done at Frankfort, Kentucky, this 7th day of March, 2002.

By the Commission

ATTEST:


Executive Director