

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INVESTIGATION INTO THE FEASIBILITY)	
OF PROPOSED MERGER OF CAWOOD)	CASE NO.
WATER DISTRICT AND BLACK MOUNTAIN)	2018-00068
UTILITY DISTRICT PURSUANT TO)	
KRS 74.361)	

NOTICE OF FILING OF FEASIBILITY STUDY

Notice is hereby given that, in accordance with the Commission’s February 19, 2018 Order, the attached report containing the findings of Commission Staff regarding the feasibility of merger between Cawood Water District and Black Mountain Utility District. Cawood Water District and Black Mountain Utility District are required to file written comments regarding the findings of Commission Staff no later than 14 days from the date of this report. Pursuant to the Commission’s Orders in Case No. 2020-00085,¹ issued March 16, 2020, and March 24, 2020, Cawood Water District and Black Mountain Utility District SHALL NOT FILE the original paper copy of its comments at this time, but rather shall file original paper copies within 30 days of the lifting of the current state of emergency.² Due to COVID-19, Commission Staff is unable to physically sign this

¹ Case No. 2020-00085, *Electronic Emergency Docket Related to the Novel Coronavirus COVID-19* (Ky. PSC Mar. 16, 2020), Order at 5–6. Case No. 2020-00085, *Electronic Emergency Docket Related to the Novel Coronavirus COVID-19* (Ky. PSC Mar. 24, 2020), Order at 1–3.

² Any electronic email filed in this matter should be sent to PSCED@ky.gov, and each message should include the case number in the subject line of the message and a read receipt to ensure the Commission received the message and documents.

report. When Commission staff is able to safely sign this report, a notice of filing with the executed signature page will be made in this case docket.

A handwritten signature in blue ink that reads "Linda C. Bridwell". The signature is written in a cursive style and is positioned above a solid black horizontal line.

Linda Bridwell
Executive Director
Public Service Commission
P.O. Box 615
Frankfort, KY 40602

DATE MAY 21 2021

cc: Parties of Record

Case No. 2018-00068

FEASIBILITY STUDY ON MERGER BETWEEN
CAWOOD WATER DISTRICT AND BLACK MOUNTAIN UTILITY DISTRICT
KENTUCKY PUBLIC SERVICE COMMISSION CASE NO. 2018-00068

INTRODUCTION

Cawood Water District (Cawood District) is a water utility district organized pursuant to KRS Chapter 74 that owns and operates a water distribution system through which it provides retail water service to approximately 1,680 customers residing in Harlan County, Kentucky.¹ Black Mountain Utility District (Black Mountain District) is a water utility district organized pursuant to KRS Chapter 74 that owns and operates a water distribution system, through which it provides retail water service to approximately 3,376 customers residing in Harlan County, Kentucky.² Black Mountain District also owns and operates a sewer collection system through which it provides sewer service to approximately seven customers residing in Harlan County, Kentucky.³ By Order dated February 19, 2018, this case was established in order to examine the feasibility of merger between the two entities after a series of events involving Cawood District during the proceedings in Case No. 2017-00309⁴ and following a letter to Harlan County Judge Executive Dan Mosley provided to the Commission from the Superintendent of Harlan County Board of Education Brent D. Roark, expressing concern for the “continued

¹ *Annual Report of Cawood Water District to the Public Service Commission for the Calendar Year Ended December 31, 2018 (2018 Annual Report of Cawood District)* at 12 and 49.

² *Annual Report of Black Mountain Utility District for Water to the Public Service Commission for the Calendar Year Ended December 31, 2018 (2018 Annual Report of Black Mountain)* at 12 and 49.

³ *Annual Report of Black Mountain Utility District for Sewer to the Public Service Commission for the Calendar Year Ended December 31, 2018*

⁴ Case No. 2017-00309, *Application of Cawood Water District for an Alternative Rate Adjustment* (Ky. PSC Dec. 14, 2017).

disruption of service provided by the Cawood Water District.”⁵ Procedurally, under KRS 74.361, this report is the initial step required of the Commission in order to further investigate merger possibility.

BACKGROUND

Cawood District was originally organized on December 10, 1964, under the provisions of KRS Chapter 74.⁶ Prior to an amendment in 1966, organizing a water district pursuant to KRS Chapter 74 did not require the prior approval of the Kentucky Public Service Commission.⁷ Cawood District’s last adjustment of rates pursuant to 807 KAR 5:076 was approved on April 8, 2021.⁸ Black Mountain District was organized in 1986 by the Harlan County Fiscal Court pursuant to KRS Chapter 74.⁹ On July 13, 2012, the Commission approved the proposed merger of Green Hills Water District and Black Mountain District.¹⁰ Black Mountain District’s last adjustment of rates pursuant to 807 KAR 5:076 was approved on November 9, 2015.¹¹

⁵ Order (Ky. PSC Feb. 19, 2018) at Appendix A.

⁶ 2018 Annual Report of Cawood District at 9.

⁷ KRS 74.012 was created in 1972 and amended in 1978, which replaced KRS 74.015 Repealed 1972 Ky. Acts ch. 310, sec. 5. – Created 1966 Ky. Acts ch. 70, sec. 3.

⁸ Case No. 2020-00311, *Electronic Application of Cawood Water District for an Alternative Rate Adjustment* (Ky. PSC Apr. 8, 2021).

⁹ Harlan County, Kentucky, Ordinance Relating to the Ratification, Confirmation, and Approval of the Creation of, and the Present Formation of Black Mountain Utility District (May 8, 1986).

¹⁰ Case No. 2012-00095, *Application of Black Mountain Utility District and Green Hills Water District for Merger Pursuant to KRS 74.363* (Ky. PSC July 13, 2012) at 9.

¹¹ Case No. 2015-00088, *Alternative Rate Adjustment Filing of Black Mountain Utility District* (Ky. PSC Nov. 9, 2015).

DISCUSSION

During the course of this case, Commission Staff has made seven requests for information to Cawood District and five requests for information to Black Mountain District. Additionally, Commission Staff has been to the offices of both Cawood District (April 25, 2018) and Black Mountain District (April 26, 2018) to perform a review of the respective utilities' financial records. Cawood District was made a party to Case No. 2019-00041¹² and after participating in discovery and hearings, it was ordered to make multiple changes to address the Commission's concerns.¹³

Through discovery in the instant case, it has become apparent that Black Mountain District is under dire financial strain. Black Mountain District has not submitted a financial audit to the Public Service Commission since 2015, until January 2, 2019, where, pursuant to the request of the Public Service Commission's filings division, Black Mountain District submitted its 2017 financial audit, which has been filed into the case record of the instant case. The 2017 financial audit is dated August 3, 2018. At the April 26, 2018 review, Black Mountain District's accountant stated that audits for 2015, 2016, and 2017 had not yet been completed because of lack of funds to pay the auditor for their services. As of the date of this report, Commission Staff is not aware if the audits for 2015, 2016, 2018, or 2019 have been completed, and if the audit for 2020 has begun. The 2017 financial audit report that has been submitted indicates that Black Mountain District experienced a net operating loss of \$413,687¹⁴ for the calendar year ended

¹² Case No. 2019-00041, *Investigation into Excessive Water Loss by Kentucky's Jurisdictional Water Utilities* (Ky. PSC Nov. 22, 2019).

¹³ *Id.*

¹⁴ Black Mountain District 2017 Financial Audit Report at 5.

December 31, 2017, before making its debt payments. According to the annual reports submitted to the Commission for the calendar years 2016, 2018, and 2019 Black Mountain District experienced operating losses of \$313,202, \$483,809, and \$422,092, respectively.¹⁵ Black Mountain District's total depreciation expense for a given calendar year is approximately \$500,000. As of December 31, 2018, Black Mountain District reported cash of \$52,570.¹⁶ The appearance is that despite the rate increase that was approved in November of 2015, Black Mountain District is using the majority of its depreciation reserve to pay current operating expenses.

During the course of Commission Staff's review of Black Mountain District's financials, it was discovered that the amounts that were reported by Black Mountain District in its 2016 annual report to the Commission had material errors in its water loss calculation. In response to Staff's Third Request for Information to Black Mountain District, Black Mountain District filed a corrected statement of water purchased and sold for the calendar year ended December 31, 2016.¹⁷ Based on the total line loss amount that is reported on this updated statement, Black Mountain District's line loss before any system flushing was 39.13 percent for 2016.¹⁸ Black Mountain District's 2017 and 2018 annual reports showed similar amounts for line loss at 33.36 and 43.87 percent, respectively.

¹⁵ *Annual Report of Black Mountain Water District to the Public Service Commission for the Year Ended December 31, 2016* (2016 Annual Report of Black Mountain District for Water) at 20. 2018 Annual Report of Black Mountain District at 21. 2019 Annual Report of Black Mountain District at 21.

¹⁶ 2018 Annual Report of Black Mountain District at 16.

¹⁷ Black Mountain Utility District Responses to Commission Staff's Third Request for Information (filed Oct. 4, 2018) at 12.

¹⁸ *Id.* Line Loss = 96,754,792 / Total Purchased 247,228,010 = Line Loss Percentage 39.13%.

Commission Staff also questions the accuracy of the information Black Mountain District reported on its 2017 and 2018 billing adjustment records.¹⁹ According to the records, Black Mountain District reported that it adjusted customer accounts for water related issues in 2017 and 2018 in the combined amount of \$96,405 and the total number of adjustments made spanned nearly 62 pages. All billing adjustments for the same period, which included garbage collection as well as nonrecurring charges and adjustments to water bills according to Black Mountain District's records totaled \$364,380. The total revenue collected for 2017 and 2018 for its water operations was \$1,649,151²⁰ and \$1,700,265,²¹ respectively. As a percentage of revenues, the total billing adjustments for water related items represented approximately 2.88 percent of total revenue for the 2017 and 2018 billing periods. During Staff's April 26, 2018 review, Black Mountain District personnel indicated that its metering system consisted of radio read meters, but despite this, adjustments needed to be made on a consistent basis. Staff questions the sheer number of billing adjustments being made, when a properly functioning AMR system should prevent the need for a large number of billing adjustments.

Despite repeated attempts to get the required information from Black Mountain District in order to make a proper determination of the feasibility of merger between the

¹⁹ Black Mountain Utility District Response to Commission Staff's Fifth Request for Information (filed Apr. 25, 2019) filed separately as two supporting documents.

²⁰ *Annual Report of Black Mountain Utility District to the Public Service Commission for the Calendar Year Ended December 31, 2017* at 48.

²¹ 2018 Annual Report of Black Mountain District at 48.

entities, Black Mountain District has either filed incomplete responses,²² or has been unable to answer Commission Staff's requests in a timely manner.²³ Black Mountain District has not retained counsel in this matter, and therefore, no motion for extension of time has been filed into the record.

CONCLUSIONS

The Commission initiated this proceeding because of concerns whether Cawood District had the ability to provide reasonable and adequate service. During the pendency of this investigation and as noted prior, Staff discovered a number of deficiencies in Black Mountain District's operations calling into question Black Mountain District's ability to provide reasonable and adequate service. Commission Staff cannot recommend that merger would benefit the ratepayers of these utilities chiefly due to Black Mountain District's financial and operational failings. Additionally, Cawood District and Black Mountain District are operationally unique,²⁴ noncontiguous systems, which would prevent certain efficiencies of scale from being possible. For example, joint purchasing of chemicals would not be possible because Black Mountain District has virtually no

²² Staff's First Request to Black Mountain District, Item 5 asked Black Mountain District to a. provide source reports for the gallons sold in Appendix A to the request and b. to reconcile any discrepancies between the gallons sold and the monthly Sales and Consumption Report provided to Staff at the April 20, 2018 field review. Black Mountain District did not provide a response to Staff's request in its August 13, 2018 response.

²³ Staff's First Request to Black Mountain District was issued on July 25, 2018, with responses due within 14 days. Black Mountain District filed its response to Staff's First Request on August 13, 2018, or 5 days after the requests were due to the Commission. Staff's Second Request to Black Mountain District was issued on August 23, 2018, with responses due back within 14 days. Black Mountain District filed its responses to Staff's Second Request on September 10, 2018, or 5 days after the request were due to the Commission. Staff's Fifth Request to Black Mountain District was issued on February 5, 2019 with responses due within 14 days. Black Mountain District filed its responses to Staff's request on April 25, 2019, or 65 days after the requests were due to the Commission.

²⁴ Cawood District produces all of its water for the Cawood system, and purchases its water for the Pathfork system. Black Mountain District purchases 100 percent of its water from the city of Harlan.

chemical expense and Cawood District requires chemicals to run its treatment plant. In addition to this, Cawood District and Black Mountain District's service territory makes it nearly impossible to consolidate its office spaces to one central office. The location of Cawood District's treatment plant, shared billing office space with the treatment plant, and its service territory is 11.5 miles through mountainous terrain apart from Black Mountain District's service territory. The city of Harlan is directly between the two distribution service territories and would make interconnection unreasonable.

On March 9, 2020, the Commission initiated Case No. 2020-00042 to investigate Black Mountain District, its individual commissioners, and its general manager for allegedly failing to comply with KRS 278.140, KRS 278.230, 807 KAR 5:006 Sections: 4(1), 4(2), 4(4), and 4(8); 26(6)(a); and 26(6)(b), and 807 KAR 5:066 Sections: 6(2); 7, and 17.²⁵ The opening Order in that case highlighted numerous operating issues as well as inspection deficiencies,²⁶ financial concerns,²⁷ and an unfilled commissioner vacancy not reported by Black Mountain District.²⁸ On or around July 28, 2020, the Commission was notified by the Harlan County Judge Executive that Black Mountain District's general manager and individual commissioners were resigning, effective July 31, 2020. As a result of these actions, the Commission found on its own motion, cause to dismiss its

²⁵ Case No. 2020-00042, *Black Mountain Utility District and its Individual commissions, Raymond Cox, Charles Hyde, Robert Simpson, Steve Sergent, Ralph Turner, and General Manager, Raymond Metcalf for Alleged Failure to Comply with KRS 278.140, 278.230, 807 KAR 5:006 Sections: 4; 25(2); 26(6) and 807 KAR 5:066 Sections: 6(2); 7, and 17* (Ky. PSC Mar. 9, 2020) at 1.

²⁶ *Id.* at 2 and 3.

²⁷ *Id.* at 4–7.

²⁸ *Id.* at 7 and 8.

investigation.²⁹ Commission Staff believes that the resignation of both Black Mountain District's board and its general manager is a step in the right direction towards its future viability. However, based upon the review of financial documents on file with the Commission as well as documentation filed in the instant case, Commission Staff recommends that Black Mountain District be required by Order to file a general adjustment of rates, or an alternative rate filing pursuant to 807 KAR 5:076 within one year in order to ensure that Black Mountain District has the financial capacity to operate successfully.

In response to findings in Case No. 2019-00041, Cawood District has made great strides operationally. The improvements included hiring two employees dedicated to leak detection, the purchase of a flow meter in an effort to combat water loss, and new management at Cawood District.³⁰ In addition to this, Cawood District has taken a positive step in ensuring financial viability by filing its alternative rate filing on September 28, 2020.³¹ On November 2, 2020, Cawood District filed several documents to comply with the Commission's November 22, 2019 Order in Case No. 2019-00041.³² Specifically,

²⁹ Case No. 2020-00042, *Black Mountain Utility District and its Individual commissions, Raymond Cox, Charles Hyde, Robert Simpson, Steve Sergeant, Ralph Turner, and General Manager, Raymond Metcalf for Alleged Failure to Comply with KRS 278.140, 278.230, 807 KAR 5:006 Sections: 4; 25(2); 26(6) and 807 KAR 5:066 Sections: 6(2); 7, and 17* (Ky. PSC Sept. 9, 2020).

³⁰ Case No. 2019-00041, *Investigation into Excessive Water Loss by Kentucky's Jurisdictional Water Utilities* (Ky. PSC Nov. 22, 2019) Appendix B, 1, and 2.

³¹ Case No. 2020-00311, *Electronic Application of Cawood Water District for an Alternative Rate Adjustment* (filed Sept. 28, 2020).

³² See Case No. 2019-00041, *Investigation into Excessive Water Loss by Kentucky's Jurisdictional Water Utilities* (Ky. PSC Nov. 22, 2019) Appendix B, 1 and 2, Cawood District submitted its Water Audit, Complete Policy and Procedures Manual, Fire Department Usage, Leak Adjustment Sheet and Meter Change Out Schedule filed November 2, 2020 in response to the general and specific orders in the Nov. 22, 2019 Order and Appendix B.

Cawood District filed a water audit, a complete policies and procedural manual, a spreadsheet to denote the fire department usage, a leak adjustment sheet and a meter change schedule.³³ The submission of the documents alone represents the commitment that Cawood District has to improving its operations and financial viability. Furthermore, Cawood District met with Commission Staff at an informal conference held on March 17, 2021, to discuss the submissions made by the utility. Representatives updated Commission Staff on the timeline in place to purchase leak detection equipment, plans to obtain training for management through Kentucky Rural Water Association and the improvements made to the utility's mapping system.³⁴ Despite the fact that the Commission has learned that both systems are temporarily being operated by Cawood District's operator, Grant Cooper, Commission Staff cannot recommend that the utilities will be best served by merging at this time. Black Mountain District's financial and operational status is failing such that it would negate the progress Cawood District has made since its involvement in Case No. 2019-00041.³⁵

Based on the foregoing Commission Staff believes the decision to effect merger between Cawood District and Black Mountain District is unfeasible and recommends that the Commission close the pending case, and Order Black Mountain District to file a rate case either by a general adjustment of rates, or an alternative rate filing pursuant to 807 KAR 5:076 within one year of the date of the Order.

³³ *Id.*

³⁴ *Id.* Post Case Filings, PSC Letter to File IC Memorandum, March 23, 2021.

³⁵ Case No. 2019-00041, *Investigation into Excessive Water Loss by Kentucky's Jurisdictional Water Utilities* (Ky. PSC Nov. 22, 2019) Appendix B, 1 and 2.

Signatures

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