

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF KIRKSVILLE)	
WATER ASSOCIATION, INC. FOR PERMISSION)	CASE NO.
TO ISSUE INDEBTEDNESS PURSUANT TO KRS)	2022-00076
278.300)	

ORDER

On March 15, 2022, Kirksville Water Association, Inc. (Kirksville Water) tendered an application, pursuant to KRS 278.300, requesting permission to assume indebtedness for a recently purchased office building. The Commission notified Kirksville Water by letter dated March 15, 2022, that its application was rejected for failure to satisfy the minimum filing requirements set forth in certain Commission regulations. Kirksville Water subsequently filed a revised application on March 25, 2022. The Commission notified Kirksville Water by letter dated March 30, 2022, that the application was again rejected for filing deficiencies. Kirksville Water subsequently cured the filing deficiencies, and its application was deemed filed as of April 27, 2022. On May 13, 2022, Staff issued Commission Staff's First Request for Information (Staff's First Request) requesting responses to be filed by May 27, 2022. In lieu of responding to Staff's First Request, Kirksville Water filed a notice of withdrawal of the application stating that the debt incurred in the purchasing of the property had been retired via cash resources. There are no intervenors in this case and the matter is now submitted to the Commission for a decision based upon the evidentiary record.

LEGAL STANDARD

KRS 278.300 requires Commission approval before a utility may “issue any securities or evidences of indebtedness, or assume any obligation or liability in respect to the securities or evidences of indebtedness of any other person.”¹ The legal standard contained in KRS 278.300(3) establishes the purview of Commission review, stating:

The commission shall not approve any issue or assumption unless, after investigation of the purposes and uses of the proposed issue and the proceeds thereof, or of the proposed assumption of obligation or liability, the commission finds that the issue or assumption is for some lawful object within the corporate purposes of the utility, is necessary or appropriate for or consistent with the proper performance by the utility of its service to the public and will not impair its ability to perform that service, and is reasonably necessary and appropriate for such purpose.

Additionally, KRS 278.300(8) establishes that KRS 278.300 does not apply if the proposed issuance of securities or indebtedness is payable at periods of not more than two years from the issuance date and any renewals of such notes do not exceed six (6) years from the initial issuance date.

WATER LOSS

Pursuant to 807 KAR 5:066, Section (6)3, water loss is limited to 15 percent for ratemaking purposes. The Commission notes that Kirksville Water reported in its 2020 Annual Report, a water loss of 15.76 percent.² Commission regulation 807 KAR 5:066(6)(3) states that for ratemaking purposes, a utility's water loss shall not exceed 15 percent of total water produced and purchased, excluding water consumed by a utility in

¹ KRS 278.300(1).

² 2020 Annual Report at 57.

its own operations. At a 15.76 percent water loss, the annual cost to Kirksville Water above 15 percent is \$3,368,³ while the total cost of water loss is \$69,833.⁴

PROPOSED FINANCING

On November 22, 2021, Kirksville Water purchased a building located at 1613 Foxhaven Drive, Richmond, Kentucky, to house office and meeting space and provide a location for customers to pay bills (Foxhaven Property).⁵ Kirksville Water stated that time was of essence as the contract on the current office space was to expire in June 2022 and was not being renewed, and, due to the competitive real estate market conditions, the Kirksville Board of Directors believed they needed to move quickly.⁶ Kirksville Water noted that the water association considered renting space, but was unable to find anything that was appropriate to fit-up or less expensive than the purchase.⁷ Further,

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	Purchased Water	Purchased Power	Total
2020 Pro Forma Expenses	\$ 425,398	\$ 17,703	\$ 443,101
Multiplied by: Water Loss in Excess of 15 Percent	0.76%	0.76%	0.76%
Excess Cost	\$ 3,233	\$ 135	\$ 3,368

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	Purchased Water	Purchased Power	Total
2020 Pro Forma Expenses	\$ 425,398	\$ 17,703	\$ 443,101
Multiplied by: Water Loss in Excess of 15 Percent	15.76%	15.76%	15.76%
Excess Cost	\$ 67,043	\$ 2,790	\$ 69,833

⁵ Application (filed March 15, 2022), paragraphs 2 and 3.

⁶ Application (filed March 15, 2022), paragraphs 1 and 8.

⁷ Application (filed March 15, 2022), paragraph 6.

Kirksville Water asserted that the new Foxhaven Property was the ideal size and location and required very little fit-up.⁸

Pursuant to KRS 278.300, Kirksville Water requested approval to assume indebtedness for the Foxhaven Property. The purchased price was \$275,500 of which \$174,250 was financed through 1st Trust Bank in Richmond, Kentucky.⁹ The terms of the loan include an interest rate of 4.5 percent over 84 months, with a balloon payment of \$131,136.16 due November 18, 2028.¹⁰ Kirksville Water maintained that the water association had sufficient cash assets to purchase the building without indebtedness, but due to the low interest rate environment, financing and retaining cash for future capital projects was a sounder fiscal choice.¹¹ Kirksville Water also claimed that the purchase would not require an increase in customers' rates.¹²

On May 13, 2022, Commission Staff issued Staff's First Request with responses due May 27, 2022. In lieu of filing responses, Kirksville Water filed a notice of withdrawal of the application stating that the debt incurred for the Foxhaven Property had been retired via cash resources and reiterated that no rate increase would be required because of this purchase and that there would be no additional burden on Kirksville Water's customers.¹³

⁸ Application (filed March 15, 2022), paragraph 7.

⁹ Application (filed April 26, 2022), paragraph 3.

¹⁰ Application (filed April 26, 2022), paragraph 4.

¹¹ Application (filed March 15, 2022), paragraph 5.

¹² Application (filed March 15, 2022), paragraph 4.

¹³ Notice of withdrawal of application for indebtedness (filed May 27, 2022).

FINANCIAL CONDITION AND RATES

A review of the Commission's records from 1985 to present revealed that Kirksville Water has not sought a general base rate adjustment other than purchased water adjustments financing approval, or in conjunction with an application for a Certificate of Public Convenience and Necessity (CPCN). The practical result of such policy is that Kirksville Water has managed to avoid Commission review of its financial records since the water association was initially established. While Kirksville Water has increased its rates as part of financing cases through the United States Department of Agriculture Rural Development (RD), the Commission's review of records in a RD financing case is limited and very different from the comprehensive review of utility's total financial stability and operational viability that takes place in a traditional rate adjustment case or an alternative rate adjustment.

In Case No. 2019-00041, the Commission found that some rural water utilities' boards failed to regularly review rates to ensure that rates were sufficient to generate the revenue needed to maintain system reliability, and that delaying regular gradual, rate adjustments could result in a deterioration of system integrity and failing infrastructure.¹⁴ A key recommendation from that proceeding was that water districts and associations should monitor the sufficiency of their base rates closely and, in general, apply for base rate adjustments on a more frequent basis.¹⁵ Following the findings and recommendations in Case No. 2019-00041, the Commission performed a limited review of Kirksville Water's annual and audit reports in this proceeding.

¹⁴ See Case No. 2019-00041, *Electronic Investigation into Excessive Water Loss by Kentucky's Jurisdictional Water Utilities* (Ky. PSC Nov. 22, 2019), final Order, Appendix L at 14.

¹⁵ Case No. 2019-00041, Executive Summary at iv.

The Commission notes that Kirksville Water maintains a large cash and cash equivalent balance, and appears to be fully funding depreciation, but there is a concern that other income sources, such as what is discussed below, is contributing to the positive cash basis income and such income sources are nonrecurring.¹⁶

Year	2016	2017	2018	2019	2020
Net Income before Contributions	\$ (339)	\$ (10,045)	\$ 19,843	\$ 11,964	\$ 24,856
Subtract: Principal Payments	(36,080)	(36,356)	(41,947)	(42,263)	(42,593)
Add: Depreciation Expense	156,972	165,531	169,741	169,745	173,480
Cash Basis Income	\$ 120,553	\$ 119,130	\$ 147,637	\$ 139,446	\$ 155,743

Year	2016	2017	2018	2019	2020
Cash and Cash Equivalents	\$ 294,325	\$ 309,850	\$ 434,153	\$ 556,828	\$ 450,789
Restricted Funds - Sinking, Depreciation	82,981	85,594	84,552	84,653	85,210
Net Increase (Decrease) in Cash	\$ 70,854	\$ 121,163	\$ 117,896	\$ 136,380	\$ (109,776)

Therefore, the Commission finds that Kirksville Water shall file an application for a general base rate adjustment or an alternative rate adjustment within six months of the date of this Order to ensure that its revenue is sufficient to support adequate and reliable service. In the alternative, Kirksville Water may file a formal motion with a detailed analysis of its rates and revenues and a statement of the reasons why a rate case is not necessary. Any filing for a rate adjustment filed under KRS 278.023 does not relieve Kirksville Water from this requirement.

¹⁶ Audit Report of Kirksville Water Association, Inc. to the Public Service Commission for the Calendar Year Ended December 31, 2016 at 5 and 10; Audit Report of Kirksville Water Association, Inc. to the Public Service Commission for the Calendar Year Ended December 31, 2017 at 5 and 10; Audit Report of Kirksville Water Association, Inc. to the Public Service Commission for the Calendar Year Ended December 31, 2018 at 5 and 10; Audit Report of Kirksville Water Association, Inc. to the Public Service Commission for the Calendar Year Ended December 31, 2019 at 5 and 9; Audit Report of Kirksville Water Association, Inc. to the Public Service Commission Calendar Year Ended December 31, 2020 at 5 and 9.

DISCUSSION AND ADDITIONAL FINDINGS

Kirksville Water is a water association created under and by the virtue of Chapter 273 of the Kentucky Revised States. Kirksville Water provides service to approximately 1,927 customers in Garrard and Madison counties, Kentucky.¹⁷

The Commission finds that although the proposed financing may have been necessary due to the conclusion of the lease at the current headquarters, the legal standard established in KRS 278.300 to approve the property acquisition are not met. KRS 278.300(1) requires Commission approval to occur *prior* to the issuance of any evidence of indebtedness.¹⁸ Kirksville Water seeks retroactive approval for an action the utility took months prior to its application for Commission approval. Further, Kirksville Water failed to either file for a CPCN for the purchase and renovation of the Foxhaven Property or a request that the Commission issue a declaratory statement that a CPCN is not needed. The Commission's standard of review for a request for a CPCN is well settled. KRS 278.020(1)(a) provides that no utility may construct any facility to be used in providing utility service to the public until it has obtained a CPCN from this Commission except as provided in KRS 278.020(1)(a)(1)-(3) and 807 KAR 5:001, Section 15(3), which are provisions not applicable to this matter. To obtain a CPCN, a utility must demonstrate a need for such facilities and an absence of wasteful duplication.¹⁹ Kirksville Water's application failed to provide enough detail to determine the extent of the construction

¹⁷ *Annual Report of Kirksville Water Association, Inc. to the Public Service Commission for the Year Ending December 31, 2020* (2020 Annual Report) at 12 and 49.

¹⁸ KRS 278.300(1) reads, "No utility shall issue any securities or evidence of indebtedness, or assume any obligation or liability in respect to the securities or evidence of indebtedness of any other person until it has been authorized to do so by order of the commission." (Emphasis added).

¹⁹ *Kentucky Utilities Co. v. Public Service Comm'n*, 252 S.W.2d 885 (Ky. 1952).

required to adapt the Foxhaven Property for use as the utility's headquarters. However, the Commission has previously required a CPCN for the purchase of an existing building and the minimal construction necessary to retrofit the building for use as a water utility headquarters, as well as for remodeling of existing facilities already in use by a utility.²⁰

The Commission also notes that Kirksville Water sold "territorial rights" for a gain of \$225,000.²¹ It is unclear to the Commission exactly what Kirksville Water sold or to whom. KRS 278.020(6) prohibits any person from acquiring or transferring ownership of, or control, or the right to control, any utility under the jurisdiction of the Commission by sale of assets, transfer of stock, or otherwise, or to abandon control of a utility without prior approval by the Commission. While it is evident that Kirksville Water has not transferred the right to control all of its operations, there is evidence that it has sold some asset(s). KRS 278.218 states that any assets that are owned by a utility shall not be transferred without prior approval of the Commission, if the assets have an original book value of \$1,000,000. The Commission does not know the original book value of the asset(s) that were transferred nor what exactly was sold as the sale could include more items than just service lines. Kirksville Water was asked to provide board/commission minutes approving this sale, a copy of the contract, and other details regarding this

²⁰ See Case No. 2016-00392 *Application of North Mercer Water District for a Certificate of Public Convenience and Necessity to Acquire a Building and Make Minimal Adaptions Thereto* (Ky. PSC Dec. 22, 2016); Case No. 2005-00277 *Application of Fleming-Mason Energy Cooperative Corporation for an Order and Certificate of Public Convenience and Necessity Authorizing Applicant to construct a Garage, Warehouse, fieldhouse, and Remodeling at Flemingsburg, Kentucky.* (Ky. PSC Oct. 14, 2005), and Case No. 2016-00181 *Electronic Application of Columbia Gas of Kentucky, Inc. for a Declaratory Order that the Construction of Proposed Gas Safety Training Facilities is in the Ordinary Course of Business and Does Not Require a Certificate of Public Convenience* (Ky. PSC Sep. 9, 2016), The Commission required a CPCN for the remodeling necessary to retro-fit a portion of an existing building to accommodate a training facility.

²¹ Application (filed March 25, 2022), KWA2021operations.pdf, pdf page 6 of 6.

transaction during discovery. However, due to Kirksville Water not responding to Staff's First Request, the information was not gleaned. Further, as discussed above, this income is nonrecurring and should not be considered when evaluating the financial viability of the water association.

The Commission further notes that in 2021, Kirksville Water received income of \$116,399 for tap/meter set fees.²² Based upon Kirksville Water's tariff on file with the Commission, a 1-inch Meter Installation is charged a fee of \$1,156, which equates to approximately 100 new customers. Although customer growth of this magnitude is not unusual if a utility is located in an area of high population growth, the Commission was unable to verify whether population growth is occurring at this rate in Kirksville Water's location, or the source of this income due to Kirksville Water's lack of response to Staff's First Request.

The Commission, on its own motion, will establish a docket for an investigation for failure to comply with KRS 278.300 and KRS 278.020 finding that a prima facie case exists for both the utility and the board of commissioners in their individual capacities. This investigation will also evaluate Kirksville Water's territorial sales and other income sources.

IT IS THEREFORE ORDERED that:

1. Kirksville Water's request for approval to assume indebtedness is denied.
2. The Commission shall establish a docket to investigate Kirksville Water and its board of commissioners for alleged violation of KRS 278.300 and KRS 278.020.

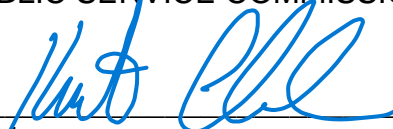
²² Application (filed March 25, 2022), KWA2021operations.pdf, pdf page 6 of 6.

3. Kirksville Water shall file an application for a general rate adjustment pursuant to 807 KAR 5:001, Section 16, or an application for an alternative rate adjustment pursuant to 807 KAR 5:076, or in the alternative, file a formal motion with a detailed analysis of its rates and revenues and a statement explaining the reasons why no modifications are necessary, within six months of the date of issuance of this Order. Any filing for a rate adjustment filed under KRS 278.023 does not relieve Kirksville Water from this requirement.

4. This case is closed and removed from the Commission's docket.

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PUBLIC SERVICE COMMISSION



Chairman

Vice Chairman

Commissioner



ATTEST:



Executive Director

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