

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF THE SOUTH)	
EASTERN WATER ASSOCIATION, INC. FOR A)	
CERTIFICATE OF PUBLIC CONVENIENCE AND)	CASE NO.
NECESSITY TO CONSTRUCT A SYSTEM)	2023-00353
IMPROVEMENTS PROJECT AND AN ORDER)	
AUTHORIZING THE ISSUANCE OF SECURITIES)	
PURSUANT TO KRS 278.023)	

ORDER

On October 31, 2023, South Eastern Water Association, Inc. (South Eastern Water) filed an application, pursuant to KRS 278.023, requesting a Certificate of Public Convenience and Necessity (CPCN) to construct a waterworks improvement project and an Order authorizing the issuance of securities¹ and for approval of its plan to finance the proposed project via a loan agreement with United States Department of Agriculture Rural Development (RD) as well as grant funds from the Cleaner Water Program.

South Eastern Water is a water association organized under KRS Chapter 273, and provides retail water service to approximately 7,930 residential customers who reside in Pulaski County, Kentucky.²

LEGAL STANDARD

Notwithstanding the Commission's general responsibilities and discretion regarding CPCNs as laid out in KRS 278.020(1), KRS 278.190, and KRS 278.300;

¹ Application at 1, paragraph 3.

² *Annual Report of South Eastern Water Association to the Public Service Commission (Annual Report) for the Calendar Year Ended December 31, 2022* at 12 and 49.

KRS 278.023(1) requires the Commission to accept agreements between water associations and RD, and to issue the necessary orders to implement the terms of such agreements no later than 30 days after the application is filed with the Commission. Additionally, the Commission has no discretionary authority to modify or reject any portion of the agreement between RD and the water association, nor to defer the issuance of all necessary orders to implement the terms of that agreement. As explained in KRS 278.023(1), the Commission's review is truncated because federal financing of these projects entails prior review and oversight by a federal agency and obligates the utility to take certain actions; conflicting requirements between the federal agency and the Commission may jeopardize the project and place the utility in an untenable position.

Therefore, the Commission is unable to review this application utilizing the standards applicable in cases not filed pursuant to KRS 278.023. The legal standard established in KRS 278.023 requires that (1) the applicant be a water utility formed under KRS Chapter 74 or 273; and (2) the construction project must be funded in whole or in part under terms of an agreement between the water utility, RD or the United States Department of Housing and Urban Development. The Commission is not, however, prohibited by KRS 278.023 from requiring a utility seeking approval of such an agreement to subsequently file reports or other information in order to monitor the utility's ability to repay the loan, meet other financial or regulatory obligations, or otherwise establish its financial condition.

PROJECT DESCRIPTION

South Eastern Water's proposed project entails construction of a new 100,000-gallon elevated water storage tank and necessary appurtenances that will replace an

existing standpipe water storage tank. The existing tank has developed several leaks over the years and rather than continuing to repair these leaks it was determined that the construction of a new tank was a better long-term solution.³ The new elevated tank will allow South Eastern Water to utilize the entirety of the tank's capacity as only the top 10-15 feet of the existing tank can be utilized effectively.⁴

South Eastern Water proposed to fund this project through the issuance of an RD loan in the amount of \$622,000,⁵ and Cleaner Water Program grant funds in the amount of \$659,497⁶. The agreement with RD requires that South Eastern Water's rates and charges must be at least adequate to meet the cost of maintaining, repairing and operating the water system, meet the required principal and interest payments, and the required deposits to debt service and/or depreciation reserve.⁷ The rates required by RD do not exceed South Eastern Water's current rates, therefore a rate increase is not necessary at this time.⁸

DISCUSSION AND FINDINGS

Commission Staff performed a limited review of South Eastern Water's financial records that are on file for the immediately preceding five years. A summary is presented in the table below. The 2021 Annual Report information is excluded. The Commission

³ Application, Exhibit A.

⁴ Application, Exhibit A.

⁵ Application, Exhibit B.

⁶ Application, Exhibit B.

⁷ Application, Exhibit B.

⁸ Application, Exhibit B, and South Eastern Water Association, Tariff, 7th revised Sheet No.6, Effective Sept. 17, 2021. All current rates approved for South Eastern Water are in excess of the rates on page 11 of the RD Letter of Conditions.

has not accepted the 2021 Annual Report because it contained several reference errors which South Eastern Water is still working to correct. The Commission finds it unacceptable that the errors to the 2021 Annual Report have not yet been corrected. Within 30 days of the date of service of this Order South Eastern Water should file all necessary information for its 2021 Annual Report.

Audited financial statements were not filed with the Commission for the years ended December 31, 2020, 2021, and 2022. South Eastern Water indicated in its response to Staff's First Request that the 2022 audited financial statements would be filed by November 17, 2023.⁹ South Eastern Water has not filed its 2022 audited financial statements as of the date of this Order. The Commission encourages South Eastern Water to timely file its audited financial statements according to the regulatory requirements.

⁹ South Eastern Water's Response to Commission Staff's First Request for Information (Staff's First Request) (filed Nov. 14, 2023), Item 4.Response_to_First_Information_Request.pdf.

South Eastern Water Association, Inc.
Analysis of Financial Statements

Description / Year	Audited 2018	Audited 2019	Annual Report 2020	N/A 2021	Annual Report 2022
<i>Adjusted Net Income</i>					
Net Income / (Loss) before Contributions	\$ (130,358)	\$ (24,614)	\$ 337,271	\$ -	\$ 101,184
Adjusted Net Income / (Loss) before Contributions	\$ (130,358)	\$ (24,614)	\$ 337,271	\$ -	\$ 101,184
Subtract: Principal Payments ()	(305,370)	(316,500)	(764,894)		(344,572)
Rate Based Income	\$ (435,728)	\$ (365,728)	\$ (427,623)	\$ -	\$ (243,388)
Add: Depreciation Expense	980,038	986,238	1,003,468		1,135,585
Cash Basis Income	\$ 544,310	\$ 620,510	\$ 575,845	\$ -	\$ 892,197

<i>Cash and Investments</i>					
Unrestricted Cash and Investments	\$ 2,761,939	\$ 2,035,198	\$ 3,734,608		\$ 1,906,865
Restricted Funds (exclude construction funds from bond proceeds)	2,903,449	4,105,430	2,500,118		2,349,280
Adjusted Cash Balances	5,665,388	6,140,628	6,234,726	-	4,256,145

Net Increase (Decrease) in Cash		\$ 475,240	\$ 94,098		N/A
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Selected Statistical Information (PSC Annual Reports)

Customer Count	7,582	7,140	7,794		7,931
Gallons Purchased	604,455	583,095	527,654		568,738
Gallons Sold	305,233	312,531	317,641		346,691
Gallons Used for Internal Use	217,972	160,984	135,658		137,118
Water Loss Gallons	81,250	109,580	74,357		84,929
System Use Percentage	36.06%	27.61%	25.71%		24.11%
Water Loss Percentage	13.44%	18.79%	14.09%		14.93%
Per Cust Per Month Gallons	3,355	3,648	3,396		3,643
Revenue	\$ 4,104,403	\$ 4,163,143	\$ 4,352,494		\$ 5,137,878
Purchased Water Expense	2,062,195	1,508,658	1,313,081		1,443,078
Purchased Water Expense Over 15% Water Loss	0	57,221	0		0
Water Loss Expense Over 15% as Percentage of Total Revenue	0.00%	1.37%	0.00%		0.00%

South Eastern Water did not fully fund depreciation in 2018, 2019, 2020, and 2022 but did have a positive cash flow for each of those years. South Eastern Water's most recent rate case was Case No. 2021-00126, which became final on September 17, 2021, and provided for an increase in revenues of \$263,372, or 6.39 percent.¹⁰ The Commission notes that the rate increase from Case No. 2021-00126 resulted in an improvement in South Eastern Water's financial condition, based on the 2022 Annual Report data, but the full impact has not been seen due to the lack of audit and 2021 Annual Report information from South Eastern Water.

The Commission notes that in its 2022 Annual Report, South Eastern Water reported flushing usage of 134,421,000 gallons which represents approximately

¹⁰ Case No. 2021-00126, *Electronic Application of South Eastern Water Association, Inc. for a Rate Adjustment Pursuant to 807 KAR 5:076*.

23.63 percent of its total water purchased over the same period.¹¹ South Eastern Water stated in response to Staff's First Request that it is a merged system comprised from four former districts resulting in a unique design which requires a higher volume of flushing.¹² In its final Order for Case No. 2021-00126, the Commission stated that "it strongly encourages South Eastern Water to pursue reasonable actions to reduce its system use. Failure by South Eastern Water to make improvements toward its operations and reducing water use may cause the Commission to pursue additional action with the utility."¹³ While the Commission notes that South Eastern Water's system use for 2022 was slightly reduced it reiterates that South Eastern Water should continue to make efforts to reduce the water used during its own operations.

Based upon the evidence of record, the Commission concludes that the KRS 278.023 legal standard to approve the proposed financing is met because South Eastern Water is a water association organized under KRS Chapter 273 and the financing for the proposed project is subject to an agreement between RD and South Eastern Water. Therefore, the Commission finds that the CPCN should be granted, and the plan of financing should be approved.

IT IS THEREFORE ORDERED that:

1. South Eastern Water is granted a CPCN for the proposed project as submitted.

¹¹ 2022 Annual Report at 57.

¹² South Eastern Water's Response to Staff's First Request, Item 2. Response_to_First_Information_Request.pdf.

¹³ Case No. 2021-00126, *Electronic Application of South Eastern Water Association, Inc. for a Rate Adjustment Pursuant to 807 KAR 5:076* (Ky. PSC Sept. 17, 2021), final Order at 4.

2. South Eastern Water's proposed plan of financing is approved.
3. South Eastern Water is authorized to execute the RD Loan and RD Grant agreements as provided.
4. The proceeds of the loans shall be used only for the purposes specified in South Eastern Water's application.
5. Within 30 days of the date of service of this Order South Eastern Water shall file the information necessary to complete its 2021 Annual Report.
6. South Eastern Water shall obtain approval from the Commission prior to performing any additional construction not expressly authorized by this Order.
7. South Eastern Water shall file with the Commission documentation of the total costs of this project, including the cost of construction and all other capitalized costs (e.g., engineering, legal, and administrative), within 60 days of the date that construction is substantially completed. Construction costs shall be classified into appropriate plant accounts in accordance with the Uniform System of Accounts for water utilities prescribed by the Commission.
8. South Eastern Water shall obtain approval from the Commission prior to performing any additional construction not expressly authorized by this Order.
9. South Eastern Water shall notify the Commission in writing one week prior to the actual start of construction.
10. South Eastern Water shall require the construction to be inspected under the general supervision of a professional engineer with a Kentucky registration in civil or mechanical engineering to ensure that the construction work is done in accordance with

the contract drawings and specifications and in conformance with the best practices of the construction trades involved in the project.

11. Any documents filed in the future pursuant to ordering paragraphs six and eight of this Order shall reference this case number and shall be retained in South Eastern Water's post-case correspondence file.

12. The Executive Director is delegated authority to grant reasonable extensions of time for filing of any documents required by this Order upon South Eastern Water's showing of good cause for such extension.

13. Nothing contained in this Order shall be deemed a warranty of the Commonwealth of Kentucky, or any agency thereof, of the financing, herein approved.

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

PUBLIC SERVICE COMMISSION

Mark Chalmers
Chairman

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Vice Chairman

Man Pat Regan
Commissioner

ENTERED
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