

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF ESTILL)	
COUNTY WATER DISTRICT NO. 1 FOR)	CASE NO.
AUTHORIZATION TO CONSOLIDATE ITS)	2018-00276
EXISTING LOANS WITH CITIZENS GUARANTY)	
BANK)	

ORDER

On December 4, 2018, Estill County Water District No. 1 (Estill District No. 1) filed an application seeking Commission approval to consolidate its existing loans of approximately \$238,415 with Citizens Guaranty Bank of Irvine, Kentucky (Citizens Guaranty), and to issue a promissory note reflecting a longer term and lower rate of interest. There are no intervenors in this case, and the matter is submitted to the Commission for a decision based upon the evidentiary record.

Estill District No. 1 proposed to retire existing promissory notes held by Citizens Guaranty in the amount of \$238,415, which were originally used to purchase a service vehicle, and to meet current operating expenses and debt service payments.¹ The outstanding balance consists of four fixed-rate loans with original principal amounts of \$100,305, \$110,330, \$110,254, and \$18,453 with interest rates ranging from 3.85 percent to 4.50 percent.² Estill District No. 1 proposes to consolidate this indebtedness and the

¹ Application, at 5, Table 3.

² *Id.*

outstanding principal amounts of approximately \$55,030, \$88,294, \$79,821, and \$15,269, totaling \$238,414, into one loan with a total principal of \$238,713 over a term of ten years, with an interest rate of 3.00 percent per annum.³ Pursuant to the terms of the promissory note, the interest rate of the proposed loan is subject to adjustment to the current market rate of interest on the third and seventh anniversaries of the note's execution. The adjusted interest rate, however, may not exceed the interest rate on two-year U.S. Government Treasury Notes auctioned most recent to the promissory note's anniversary date plus 1.5 percent.⁴ The promissory note will be secured with Estill District No. 1's existing accounts receivable balance and any acquired after the execution of the promissory note, and by a security interest in the service vehicle purchased originally with the proceeds of Note No. 37095, with an original cost of \$18,453.

In support of its Application, Estill District No. 1 provided an expected amortization schedule for the consolidated loan that shows the total principal and interest payments on the proposed debt will be approximately \$276,586.⁵ Under the current loan agreements, the total principal and interest payments, including balloon payments of \$55,210 and \$59,721 due in 2019, \$10,080 due in 2020, and \$61,137 due in 2021, would total approximately \$248,421.

While the proposed loan will not result in net savings, it will result in an improved cash flow, which will enable Estill District No. 1 to timely reschedule existing United States Department of Agriculture Rural Development (RD) debt. In addition to the loan

³ Estill District No. 1 did not reconcile the difference of \$298 between the total principal owed on the four outstanding loans and the consolidated loan proposed in its application.

⁴ *Id.* at 11.

⁵ *Id.* Exhibit 11.

consolidation being requested in its Application, Estill District No. 1 also stated that it has been in negotiations with RD to reamortize and reschedule its current bond issuances under which Estill District No. 1 is considered to be a delinquent borrower.⁶ While the proposed reamortization and rescheduling of Estill District No. 1's existing RD debt does not require Commission authorization,⁷ as a condition to the reamortization and rescheduling of its debt, Estill District No. 1 must demonstrate that it has sufficient cash flow to meet the revised payment schedule and the reserve requirements of its loan. To accomplish this, the approval and implementation of the loan consolidation with Citizens Guaranty is necessary. The reamortization and rescheduling of the RD debt at the current rate will reduce the annual debt service by about \$80,527 over the next five years on average.⁸ However, to ensure it receives that reduction, Estill District No. 1 requested a decision no later than December 27, 2018, because the current RD poverty lending rate of 2.375 percent per annum will only remain in effect until December 31, 2018.

The Commission has reviewed the proposed loan consolidation and finds that while the terms of the consolidation do not provide positive gross savings for Estill District No. 1, there is some value in that the proposed consolidation improves Estill District No. 1's cash flow position in the short term. Further, the improved cash flow position will permit Estill District No. 1 to restructure its RD debt as discussed above, which will reduce its annual debt service on the RD debt by about \$80,527 annually over each of the next five years. In addition to improving its cash flow position, Estill District No. 1 has stated

⁶ *Id.* at 8.

⁷ *Id.* at 14, and KRS 278.300(10).

⁸ *Id.* at 20.

that it waives any right in any future general rate proceeding to recover through rates the portion of the promissory note's debt service payments related to these notes,⁹ thereby recognizing the Commission's Order in Case No. 2017-00176 that found through the adoption of the findings of the Commission Staff Report that rate recovery of debt service payments on notes issued without Commission approval and used to pay for operating expenses and debt service payments would constitute retroactive ratemaking.¹⁰

Having considered the evidence of record and being otherwise sufficiently advised, the Commission finds, subject to the conditions discussed herein and in Estill District No. 1's application, that the proposed loan from Citizens Guaranty is for lawful objects within the corporate purposes of Estill District No. 1; is necessary and appropriate for and consistent with the proper performance by the utility of its service to the public; will not impair its ability to perform that service; is reasonable, necessary, and appropriate for such purposes; and should therefore be approved.

However, the Commission observes that authorizing Estill District No. 1 to refinance the Citizens Guaranty loans, and thereby restructure the RD debt only buys it time—it does not correct systemic problems that have led to its current financial crisis. First among those problems is water loss, which Estill District No. 1 reported to be 35.2625 percent in its 2016 Annual Report. Commission regulations state that a utility's unaccounted-for water loss for ratemaking purposes shall not exceed 15 percent of the total water produced and purchased, excluding water consumed by a utility in its own

⁹ *Id.* at 13.

¹⁰ Case No. 2017-00176, *Electronic Application of Estill County Water District No. 1 for Rate Adjustment Pursuant to 807 KAR 5:076* (Ky. PSC Dec. 20, 2017).

operations.¹¹ Reduction of Estill District No. 1's unaccounted-for water loss to 15 percent would result in an approximate \$147,680 decrease to purchased water expense,¹² which means Estill District No. 1 is paying approximately \$0.90 per 1,000 gallons sold for expenses associated with unaccounted-for water loss greater than 15 percent.¹³ Thus, it would likely prove futile to authorize the loan herein without simultaneously ensuring that Estill District No. 1 is taking steps to correct the primary cause of its financial condition.

Estill District No. 1's new board indicated in the Application and in testimony that it recognized the significance of its water loss and that it was taking steps to address it.¹⁴

¹¹ 807 KAR 5:066(6)(3).

¹²

Purchased Water/Power from 2016 Annual Report	\$	728,833
Times: Water Loss Above 15 Percent		<u>20.2625%</u>
Purchased Water Expense Reduction	\$	<u><u>147,680</u></u>

¹³

Purchased Water Expense Reduction	\$	147,680
Divide by: Water Sales (in 000s)		<u>164,453</u>
Amount per 1,000 gallons sold	\$	<u><u>0.90</u></u>

¹⁴ See Application at Paragraph 8, 13 ("Its financial problems stem from a high rate of unaccounted-for water loss. As shown in Table 1 below . . . [s]ince 2014, it has experienced an unaccounted water rate in excess of 35 percent."); Click Testimony at 3, 6 ("Its financial problems stem from a high rate of unaccounted-for water loss. . . . Shortly after the Commission denied the request for authorization for the proposed KRWFC loan, three new commissioners were appointed to Estill District's Board of Commissioners. As a Board, we have focused exclusively on two issues: restructuring Estill District's delinquent RD loans and reducing Estill District's unaccounted-for water loss. For purposes of my testimony today, I will address only our efforts regarding debt restructuring.").

However, while the Commission appreciates the new board's recognition of the problem and intent to resolve it; the Commission believes that it must hold Estill District No. 1 accountable for the excessive water loss to ensure that the time this loan and the RD debt restructuring give Estill District No. 1 to correct the issue is used wisely. Given Estill District No. 1's history of non-compliance and its financial condition, it may not get another opportunity to correct the water loss issues. Thus, while Estill District No. 1 has authority to obtain the loan as requested, it must also file a detailed and comprehensive plan to correct its excessive water loss on or before April 1, 2019, to permit the Commission to monitor its progress in resolving that issue.

Finally, while the Commission was able to address this Application within the period requested, utilities and practitioners, particularly those with a history of urgent requests, should not count on the Commission making such prompt decisions. If the Commission had been unable make a decision approving the loan on the written record or if other pressing matters fell within the window provided by Estill District No. 1, the Commission would not have been able to issue this order within the time requested, and Estill District No. 1's financial condition would have suffered. Thus, to ensure that those responsible meet their fiduciary and professional responsibilities, applications and other requests for action by the Commission must be filed in timely manner, which at a minimum should be 60 days before approval is required for applications for authority to incur debt.

IT IS THEREFORE ORDERED that:

1. Estill District No. 1 is authorized to borrow from Citizens Guaranty no more than the total amount needed to pay off the loans proposed to be consolidated as proposed in its the Application.

2. Estill District No. 1 shall only agree to such terms and conditions that are consistent with the parameters set out in its Application.

3. The proceeds from the loan authorized herein shall be used only for the purposes set out in the Application.

4. Within ten days of the execution of the new Citizens Guaranty loan documents, Estill District No. 1 shall file with the Commission one copy in paper medium and an electronic version of the loan documents.

5. Estill District No. 1 shall file a detailed and comprehensive plan to correct its excessive water loss on or before April 1, 2019.

6. Failure to file the plan required by ordering paragraph 5 may result in the imposition of penalties pursuant to KRS 278.990 or other actions as deemed appropriate by the Commission.

7. Any documents filed pursuant to ordering paragraphs 4 and 5 shall reference this case number and shall be retained in the post-case correspondence file.

8. Nothing contained herein shall be deemed a warranty or finding of value for the debt authorized herein on the part of the Commonwealth of Kentucky or any agency thereof.

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

By the Commission

ENTERED
DEC 21 2018
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:


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