

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

JOINT PETITION OF THE CITY OF PIKEVILLE )  
AND MOUNTAIN WATER DISTRICT FOR THE ) CASE NO. 2006-00123  
TRANSFER OF CERTAIN WASTEWATER )  
FACILITIES AND RELATED DEBT )

ORDER

Mountain Water District ("Mountain District") and the city of Pikeville, Kentucky ("Pikeville") (collectively "Joint Applicants") jointly applied for approval of the proposed transfer of Mountain Water District's Mossy Bottom Sewer Collection System facilities to Pikeville.<sup>1</sup>

Having considered the application and evidence of record, the Commission finds that:

1. Mountain District, a water district organized pursuant to KRS Chapter 74, owns and operates sewage collection and treatment facilities in Pike County, Kentucky

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<sup>1</sup> The Joint Applicants filed their application with the Commission on March 21, 2006. Noting its objections to the proposed transfer, the city of Prestonsburg ("Prestonsburg") moved for intervention in this proceeding. It subsequently *withdrew its motion for intervention but reserved its right to intervene* in any Commission proceeding related to the transfer of certain water distribution facilities pursuant to the "Interlocal Agreement Relating to Water and Sewer Service Along U.S. 23 in the Harold/Betsy Lane/Mare Creek Area of Floyd County and the Mossy Bottom/Coal run Area of Pike County, Kentucky." Because of Prestonsburg's initial objections to the proposed transfer and its motion for intervention, the Commission, pursuant to KRS 278.020(5), extended the period for its review of the application to 120 days.

Commission Staff has propounded two sets of interrogatories and requests for production of documents to the Joint Applicants. (Commission Staff's second set was directed primarily to Mountain District.) Responses to these requests have been filed with the Commission. Commission Staff further held a telephone conference call to clarify certain responses to the first set of interrogatories and to discuss deficiencies in those responses.

The only party in this proceeding, besides the Applicants, is the Attorney General. On April 24, 2006, he moved for full intervention in this proceeding. The Commission granted his motion on April 28, 2006. The record does not reflect any further participation by him in this proceeding after that date.

that serve approximately 1,247 customers in Pike and Floyd counties, Kentucky.<sup>2</sup> Of the 1,247 customers, approximately 1,036 customers are residences and 211 are multi-family residences.<sup>3</sup>

2. Mountain District is not subject to the regulation of any metropolitan sewer district.

3. As of December 31, 2005, Mountain District reported net utility plant of \$20,620,691.<sup>4</sup>

4. As of December 31, 2005, Mountain District reported total assets of \$21,288,668.<sup>5</sup>

5. As of December 31, 2005, Mountain District reported total long-term debt of \$2,746,152; total current and accrued liabilities of \$82,748; advances for construction of \$12,713,648; and contributions in aid of construction of \$6,250,137.<sup>6</sup>

6. Mountain District operates a separate sewage collection and treatment facility that provides sewage collection and treatment services to the Mossy Bottom area of Pike County, Kentucky.

7. The Mossy Bottom Sewer Collection and Treatment Facilities serve approximately 251 residential customers and 119 commercial customers.<sup>7</sup>

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<sup>2</sup> Annual Report of Mountain Water District (Sewer Operations) to the Public Service Commission for the Year Ended December 31, 2005 ("Annual Report") at 1 and 12.

<sup>3</sup> Id. at 12.

<sup>4</sup> Id. at 4.

<sup>5</sup> Id. at 2.

<sup>6</sup> Id. at 3.

<sup>7</sup> Joint Petition at ¶1.

8. During the 12-month period ending December 31, 2005, Mountain District's sewer operations had total revenues of \$688,839; total expenses of \$404,674; and a net operating income of \$288,667.<sup>8</sup>

9. During the 12-month period ending December 31, 2005, Mountain District's Mossy Bottom Sewage System operations had total revenues of \$230,000 and total expenses of \$168,937, resulting in a net operating income of \$61,063.<sup>9</sup>

10. During the 12-month period ending December 31, 2005, Mountain District's sewer operations, exclusive of the Mossy Bottom Sewage System operations, had total revenues of \$458,839 and total expenses of \$235,737, resulting in a net operating income of \$227,604.<sup>10</sup>

11. The original cost of the Mossy Bottom Sewage System assets is \$4,256,743. Mountain District financed this cost through contributions in aid of construction of \$2,534,450<sup>11</sup> and the issuance of debt instruments in the amount of \$1,722,293.

12. Mountain District currently has the following debt obligations that are secured by liens on the Mossy Bottom Sewage System: Rural Development Loan No. 92-19, Kentucky Infrastructure Authority Loan No. A95-16, and Kentucky Infrastructure Loan No. A00-03.

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<sup>8</sup> Mountain District's Response to Commission Staff's Second Set of Interrogatories and Requests for Production of Documents, Item 3.

<sup>9</sup> Id.

<sup>10</sup> Id.

<sup>11</sup> These contributions include: a Kentucky Infrastructure Authority grant of \$1,000,000; Economic Development Administration grants of \$207,750 and \$818,600; and an Appalachian Regional Commission grant of \$375,000. Mountain District's Response to Commission Staff's Second Set of Interrogatories and Requests for Production of Documents, Item 4.

13. As of July 1, 2006, the unpaid principal on Rural Development Loan No. 92-19 is \$161,300.<sup>12</sup>

14. As of July 1, 2006, the unpaid principal on Kentucky Infrastructure Authority Loan No. A95-16 is \$314,403.50.<sup>13</sup>

15. As of July 1, 2006, the unpaid principal on Kentucky Infrastructure Authority Loan No. A00-03 is \$924,250.79.<sup>14</sup>

16. Mountain District proposes to transfer to Pikeville its Mossy Bottom Sewage System pursuant to the following terms:

a. Mountain District will convey to Pikeville all assets comprising the system, except for the Mossy Bottom Wastewater Treatment Plant, the real estate upon which that plant is located and certain other assets. Assets that Mountain District will transfer include the system's sewer lift stations and related appurtenances, the real estate upon which the lift stations are located, sewer gravity lines, sewer force mains, laterals, grinder pumps, vaults, valves, business records, and plans.

b. Mountain District will convey to Pikeville all rights to provide wastewater service in the Mossy Bottom service area as the area is described in Mountain District's Regional Facilities Plan.

c. Pikeville will assume and become solely responsible for the outstanding balances on Rural Development Loan No. 92-19, Kentucky Infrastructure

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<sup>12</sup> Letter from Jimmy H. Hall, Morehead Area Manager, Rural Development, to Trish Varney, Mountain Water District (July 3, 2006).

<sup>13</sup> Letter from Sandy Williams, Financial Analyst, Kentucky Infrastructure Authority, to Trish Varney, Mountain Water District (June 30, 2006).

<sup>14</sup> Id.

Authority Loan No. A95-16, and Kentucky Infrastructure Authority Loan A00-03, but will assume none of Mountain District's other debts or liabilities.

d. Pikeville will not increase its rate for wholesale water service to Mountain District for 24 months following the date of the transfer of the sewer collection facilities.

17. Mountain District reports the original cost of the assets that will be transferred to Pikeville as \$3,174,936 and accumulated depreciation on those assets as \$1,802,913.

18. Pikeville, a city of the third class,<sup>15</sup> owns and operates sewage collection and treatment facilities that serve approximately 2,696 customers. As of June 30, 2005, Pikeville's sewer operations had net assets of \$6,006,804.

19. Pikeville contracts with Veolia Water North America for the operation of its wastewater facilities. Veolia Water North America employs 9 persons to operate Pikeville's wastewater treatment, including a Class I and a Class III wastewater treatment plant operator.<sup>16</sup>

20. Pikeville owns and operates an extended aeration wastewater treatment facility that has a capacity of 2.0 million gallons per day.<sup>17</sup>

21. The Kentucky Infrastructure Authority has approved Pikeville's assumption of all obligations associated with Kentucky Infrastructure Authority Loan No. A95-16,

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<sup>15</sup> KRS 81.010(3).

<sup>16</sup> Joint Applicants' Response to Commission Staff's First Set of Interrogatories and Requests for Production of Documents, Item 9.

<sup>17</sup> Governor's Water Resource Development Commission, Water Resource Development: A Strategic Plan for Wastewater Treatment, Appendix B – Big Sandy Area Development District at 26 – 27 (found at <http://kia.ky.gov/NR/rdonlyres/453ECD6D-2639-4075-9407-E733D6346F4/0/sewky.pdf>).

and Kentucky Infrastructure Loan A00-03.<sup>18</sup> Rural Development has not yet acted upon the Joint Applicants' request for approval of Pikeville's assumption of all obligations associated with Rural Development Loan No. 92-19.

22. The proposed transfer will permit Pikeville to expand its wastewater services to areas outside its existing service area, make better use of the available capacity of its existing wastewater treatment facilities, and create greater economies of scale.

23. The proposed transfer will permit Mountain District to relocate its Mossy Bottom Treatment Plant to another area that does not currently have sewage treatment facilities and thus avoid the expense of purchasing a new sewage treatment plant.

24. For at least one year following the completion of the proposed transfer, Pikeville will continue to assess Mountain District's current rates for wastewater service to persons who are currently served by the Mossy Bottom Sewer Collection facilities. Pikeville presently has no plans to revise these rates.

25. The proposed transfer will not detrimentally affect Mountain District's remaining sewage collection and treatment operations.

26. Mountain District proposes to record the transaction in the following manner:

<u>Description</u>	<u>Debit</u>	<u>Credit</u>
Accumulated Depreciation	\$1,802,913.41	
Contributions in Aid of Construction	1,452,643.15	
Long-Term Debt	1,238,654.29	
Bonds	161,300.00	
Utility Plant in Service		\$3,174,936.29
Gain (Losses) from Disposition of Property		1,480,574.56

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<sup>18</sup> Joint Applicants' Response to Commission Staff's First Set of Interrogatories and Requests for Production of Documents, Item 1(b).

27. The amount that Mountain District proposes to debit to accumulated depreciation in its proposed journal entry is materially overstated. In its Report for Calendar Year 2005, Mountain District reported accumulated depreciation of \$1,338,570 on total utility plant in service of \$8,041,456.<sup>19</sup> In this proceeding, however, it reported accumulated depreciation of \$1,802,913 on the facilities that it proposes to transfer to Pikeville.<sup>20</sup> It reports the original cost of these assets as \$3,174,936.<sup>21</sup> As the accumulated depreciation that Mountain District reports for the transferred facilities exceeds Mountain District's accumulated depreciation for its total utility plant, the amount of accumulated depreciation for the transferred facilities appears in error. This error appears to result in part from Mountain District's calculation of accumulated depreciation on the sewer collection mains that it proposes to transfer. It reports that sewer collection mains constitute \$1,104,186.88 of the original cost of the transferred assets and that their capitalization date is April 1, 2004. It further reports that these mains will be fully depreciated on or before July 31, 2006. Two years is not a reasonable useful life for sewage collection mains.<sup>22</sup>

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<sup>19</sup> Annual Report at 2 and 5.

<sup>20</sup> Mountain District's Response to Commission Staff's Second Set of Interrogatories and Requests for Production of Documents, Item 4.

<sup>21</sup> Id.

<sup>22</sup> See, e.g., Commission on Rural Water, O&M Guide for the Support of Rural Water Systems 246-247 (1974). Mountain District should review and revise its calculation of accumulation depreciation on all Mossy Bottom Sewage System assets, including those that will not be transferred. The Commission places Mountain District on notice that we will carefully review the journal entry submitted in response to this Order and that, should these entries appear inconsistent with generally accepted accounting principles, we will direct Commission Staff to examine Mountain District's records regarding all Mossy Bottom Sewage System assets.

Based upon these findings, the Commission makes the following conclusions of law:

1. Mountain District is a utility that is subject to Commission jurisdiction.<sup>23</sup>
2. Pikeville is not a utility and is therefore currently not subject to Commission regulation.<sup>24</sup>
3. Pikeville is a "person" for purposes of KRS Chapter 278.<sup>25</sup>
4. KRS 278.020(5) provides that "[n]o person shall acquire or transfer ownership of, or control, or the right to control, any utility under the jurisdiction of the commission . . . without prior approval by the commission." As Pikeville is a person and is acquiring ownership of Mountain District's sewage treatment facilities, this statute is applicable to and requires Commission approval of the proposed transfer.
5. KRS 278.020(6) provides that "[n]o individual, group, syndicate, general or limited partnership, association, corporation, joint stock company, trust, or other entity (an "acquirer"), whether or not organized under the laws of this state, shall acquire control, either directly or indirectly, of any utility furnishing utility service in this state, without having first obtained the approval of the commission." As Pikeville is acquiring control of a significant portion of Mountain District's utility operations through the acquisition of the facilities that Mountain District uses to provide utility service, this statute is applicable to and requires Commission approval of the proposed transfer.

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<sup>23</sup> KRS 278.010(3)(f); KRS 278.015; KRS 278.040.

<sup>24</sup> KRS 278.010(3)(f).

<sup>25</sup> KRS 278.010(2).



6. Pikeville has the financial, technical, and managerial abilities to provide reasonable service to Mountain District customers who currently receive sewer service through the Mossy Bottom Sewer Collection facilities.

7. The proposed transfer is in accordance with law and for a proper purpose; it will, however, be consistent with the public interest only if the conditions set forth in Ordering Paragraph 1 of this Order are met.

8. Upon completion of the proposed transfer, the Mossy Bottom Sewer Collection facilities cease to be subject to Commission jurisdiction.

IT IS THEREFORE ORDERED that:

1. The proposed transfer of Mountain District's Mossy Bottom Sewer Collection facilities to Pikeville is approved subject to the conditions set forth below:

a. The transfer shall not occur until Rural Development has approved Mountain District's delegation of all obligations arising out of Rural Development Bond No. 92-19 to Pikeville and released Mountain District of all obligations related to that bond issuance.

b. Mountain District shall file with the Commission within 20 days of the date of this Order a detailed plant and accumulated depreciation schedule for "Utility Plant in Service" as of June 30, 2006.

2. Within 10 days of completion of the proposed transfer of assets, Mountain District and Pikeville shall notify the Commission in writing of the completion of the transfer of assets.

3. Mountain District shall include all transactions related to the Mossy Bottom Sewer Collection System during the period in calendar year 2006 that it owned and operated the transferred assets in its financial and statistical report<sup>26</sup> for that calendar year.

4. Within 10 days of the completion of the proposed transfer, Mountain District shall file with the Commission the journal entry that it proposes to record the asset transfer. The acquisition shall be recorded in accordance with the Uniform System of Accounts for Sewer Utilities.

Done at Frankfort, Kentucky, this 18th day of July, 2006.

By the Commission

ATTEST:



Executive Director

<sup>26</sup> Administrative Regulation 807 KAR 5:006, Section 3(1), requires "[e]very utility shall file annually a financial and statistical report upon forms to be furnished by the commission. This report shall be based upon the accounts set up in conformity with the uniform system of accounts for utilities."