

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INVESTIGATION INTO THE)
OPERATIONS AND MANAGEMENT) CASE NO. 96-126
OF MOUNTAIN WATER DISTRICT)

O R D E R

On April 2, 1996, the Commission initiated an investigation into the management and operations of Mountain Water District ("Mountain"). The investigation was precipitated by several factors, including concerns regarding management of Mountain, consistent and substantial operating losses, reports of line loss exceeding 30 percent, and a Mountain request for Commission Staff ("Staff") assistance in conducting a review of Mountain's financial operations as the basis for a rate study. In response to these concerns, the Commission directed a management audit of Mountain which was conducted by the Barrington-Wellesley Group, and issued a Staff Report recommending appropriate rates for Mountain. The Barrington-Wellesley Management Audit Report was issued in October 1996 and contained 42 recommendations for improvements, several of which involved additional expenditures necessary to "bring Mountain to a requisite level of service and operations."¹ Action plans to implement the management audit recommendations which were jointly developed by Barrington-Wellesley and Mountain were submitted to the Commission on November 1, 1996. Subsequently, the Staff

¹ Barrington-Wellesley Group Management Audit Report, page I-6.

Report was issued on May 30, 1997 recommending a permanent increase in annual water revenues of \$1,395,321 and an annual line-loss surcharge of \$277,225 for a 3-year period.

Prior to the issuance of the Staff Report, on March 5, 1997, Mountain filed Case No. 97-112,² which involved construction of a new sewer treatment plant and a request for increased water and sewer rates pursuant to KRS 278.023. That statute requires Commission approval of agreements between federal agencies and water districts and associations as a result of federally funded construction projects. The Commission approved the sewer rate increase by final Order dated March 11, 1997 but denied the proposed increase in water rates because the construction project involved only sewer facilities. By Order dated April 1, 1997, the Commission denied Mountain's request for rehearing in that proceeding and suggested that Mountain consider filing a motion for emergency rate relief in this proceeding. Subsequently, Mountain filed such a request, which was approved by the Commission for water service rendered on and after May 2, 1997.

The Commission received numerous comments and complaints from Mountain's customers. In addition, the Attorney General and the Concerned Citizens of Pike County, Inc. ("Concerned Citizens") requested and were granted intervention in this

² Case No. 97-112, The Application of Mountain Water District of Pike County, Kentucky, for a Certificate of Public Convenience and Necessity to Construct, Finance and Increase Rates Pursuant to KRS 278.023.

proceeding. A formal hearing was held on Mountain's emergency rate relief request on April 23, 1997, and a formal hearing was held on permanent rates on June 24, 1997.

The following are the Commission's discussions and findings on the issues raised in this proceeding:

STAFF REPORT RECOMMENDATIONS

The Staff Report recommendations included rates which would allow Mountain to meet its operating expenses and service its debt, resulting in an annual increase in water revenues of \$1,395,321; an annual line loss surcharge of \$277,225 for a 3-year period; various reporting requirements relative to the surcharge; and a notice to Mountain that it should file for appropriate sewer rate relief within a year from the completion of the construction approved in Case No. 97-112, if the current sewer rates prove insufficient at that time. At the hearing, Staff witnesses were made available for cross-examination; however, the basic conclusions and recommendations of the Staff Report were unchallenged. Therefore, the Commission accepts the findings and recommendations of the Staff Report with the following qualifications.

The merits of an annual line loss surcharge to address Mountain's water loss were uncontested. However, the Pike County Judge/Executive proposed, and the Pike County Fiscal Court subsequently voted, to allocate \$200,000 from Pike County government to ease the financial burden upon Mountain's ratepayers through a one-year moratorium on the surcharge.³ While the Commission accepts this proposal and finds it to be

³ Letter from Judge/Executive Donna Damron dated July 11, 1997.

commendable, Mountain and Staff testified that a one-time contribution of \$200,000 is insufficient to solve an ongoing problem.⁴ Therefore, at the end of one year, the surcharge shall be assessed unless Mountain can demonstrate substantial progress in its line loss reduction efforts, although any additional allocations from Pike County government could be used further to delay the institution of the surcharge. Any such contributions received by Mountain over the 3-year period should be accumulated in the special interest bearing account called for in the Staff Report, and should be subject to the operational and reporting requirements recommended in the Staff Report and adopted herein. Also, consistent with a Staff Report recommendation, the surcharge should not be assessed upon wholesale sales to Martin County Water District. Within 11 months from the date of this Order, Mountain should file a report with the Commission discussing its overall progress relative to line loss reductions, any additional contributions from Pike County government, and whether the surcharge will be instituted after one year or be further delayed because of additional contributions.

Relative to Staff's recommendation that Mountain should file for appropriate rate relief if sewer rates prove insufficient due to the construction project, the Commission notes that Mountain has consistently overestimated the number of people who will take water utility service, resulting in insufficient revenues. Consequently, the Commission believes that both water and sewer rates should again be reviewed within a reasonable period of time. Therefore, Mountain should file a rate case for its entire sewer

⁴ T.E., Volume I, page 241; Volume II, page 135.

operations within one year of the sewer project's completion. In addition, Mountain should conduct a rate review of its entire water operations within 3 years of the date of this Order.

Finally, the Staff Report did not include a payment to Barrington-Wellesley for its testimony in this case, which was filed subsequent to the hearing.⁵ The amount of \$9,220 should be amortized over 3 years, increasing Mountain's revenue requirement by \$3,073.

MANAGEMENT ISSUES

Testimony at the hearing as well as other information provided by Mountain indicates that the District has made some efforts to begin to resolve its numerous problems. Particularly encouraging to the Commission is evidence of greater oversight and accountability by Mountain's Board of Commissioners, and the recent appointment of a Commissioner with a financial background as recommended by the management audit. However, the Commission urges Mountain's management and local authorities to intensify their efforts to improve Mountain's management and operations, as they have an obligation to ensure that Mountain's customers receive adequate service at reasonable rates.

In particular, the Commission expresses its concern with the insufficiency of Mountain's business plan. Several of the components of the plan lacked the necessary specificity, including benchmarks or timetables, to provide assurance that Mountain will

⁵ Invoice dated June 27, 1997.

correct its problems in a timely manner.⁶ However, the Commission will closely scrutinize Mountain's action plans and will expect immediate implementation of these plans where warranted. We will monitor Mountain's immediate progress through the management audit follow-up process, and also will expect significant improvements to be reported in future rate proceedings.

We also urge Mountain to continue to explore all feasible long-term solutions to its problems, including the potential for privatization, mergers, consolidation, satellite management, or specific management contracts for services such as meter reading. Mountain should also continue to pursue avenues to refinance and reduce its present cost of debt, and report such to the Commission within 3 months.

LEGAL AND ENGINEERING ISSUES

The management audit report and the testimony in this proceeding suggest that Mountain has numerous operational problems that may have been caused by poor design and construction practices. For instance, the management audit discussed reservoirs which were inoperable because their elevation was too low, pumping stations with inadequate suction capacity or insufficient lift to serve all customers, pressure regulator stations that would have been unnecessary if pipe of sufficient strength had been installed, and pipelines which were inadequate to support the water pressure

⁶ T.E., Volume II, pages 77-79.

necessary to provide service to potential customers. In addition, testimony at the hearing suggested that new sections of line were improperly installed.⁷

In response to this evidence, the Attorney General suggested that Mountain should pursue legal remedies to address the prior construction and design problems with its contractors. In particular, the Attorney General recommended that Mountain examine its contractors' liability and seek compensation to handle any problems. The Commission agrees with the Attorney General and strongly urges Mountain to aggressively pursue such legal options.⁸

Relative to system design, the Commission is persuaded by the evidence in this case that an independent, comprehensive engineering evaluation of the Mountain system is required to address its operational problems. Therefore, we will direct a comprehensive operational analysis of Mountain's existing water treatment and distribution system to be conducted pursuant to KRS 278.255, starting within 6 months. The Commission will issue a Request for Proposals, select the consultant, and monitor the progress of the study. We expect the consultant's report to address long-term solutions to Mountain's operational problems, including water supply options, strengthening the present distribution system, future expansion requirements, line loss reduction, and any other feasible system improvements to lower costs and improve service to Mountain's customers.

⁷ T.E., Volume I, pages 239-240.

⁸ T.E., Volume II, page 143.

SUMMARY

The Commission, after considering the record and being otherwise sufficiently advised, finds that:

1. The recommendations and findings contained in the Staff Report, as modified herein, are supported by the evidence of record, are reasonable, should be adopted as the findings of the Commission in this proceeding, and are incorporated by reference as if fully set out herein.

2. Mountain should be authorized to assess a surcharge of \$0.45 per thousand gallons for a period not to exceed 3 years, or until \$831,675 has been collected. The surcharge should be suspended for one year from the date of this Order. Thirty days prior to collecting the surcharge, Mountain should file a tariff setting out the surcharge amount. Any contributions from Pike County should be included with the surcharge collections to be used for the same purposes, and would ultimately delay the collection period and reduce the financial burden upon Mountain's customers. The proceeds of the surcharge should be invested in a separate interest bearing account and used solely for line loss reduction efforts.

3. Mountain should list the surcharge as a separate line item on each customer's bill.

4. Martin County Water District should not be assessed the surcharge, consistent with the Staff Report's recommendation.

5. Mountain should submit to the Commission, concurrent with its Management Audit Progress Reports, Surcharge Reports containing the following information:

- a. Monthly surcharge billings, collections, and contributions for the period.
- b. Cumulative surcharge billings, collections, and contributions.
- c. Monthly bank statements for the interest bearing surcharge account.
- d. A descriptive list of the amounts expended from the account to reduce water loss.
- e. Copies of the supporting invoices.
- f. A narrative explanation of the steps taken to correct the line loss, including an analysis of each step's effect on line loss. In addition, Mountain should file by July 15, 1998 a report discussing its overall progress relative to line loss reduction, any additional contributions from Pike County government, and whether the surcharge will be instituted after one year or further delayed because of additional contributions.

6. Failure to submit the required reports should result in the forfeiture of Mountain's surcharge and the refund of the proceeds plus interest to customers.

7. Mountain should provide a written report with supporting documentation which describes its efforts to refinance and reduce its present cost of debt from all lending sources by November 15, 1997.

8. Within one year of the completion of the sewer construction approved in Case No. 97-112, Mountain should file a rate case for its entire sewer operations.

9. Mountain should conduct a rate review for its entire water operations by August 15, 2000.

10. The rates in Appendix A are the fair, just and reasonable rates for Mountain and will produce gross annual revenues of \$ 4,399,114. These rates will allow Mountain to meet its operating expenses and service its debt.

IT IS THEREFORE ORDERED that:

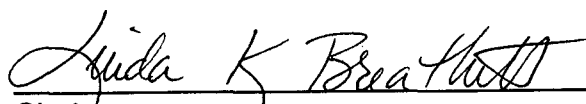
1. The rates in Appendix A are approved for service rendered by Mountain on and after the date of this Order.


2. Within 30 days of the date of this Order, Mountain shall file with the Commission its revised tariff setting out the rates approved herein. Thirty days prior to collecting the surcharge, Mountain shall file a tariff setting out the surcharge amount.

3. Mountain shall comply with all matters set out in Findings 1 through 9 as if the same were individually so ordered.

Done at Frankfort, Kentucky, this 11th day of August, 1997.


PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman

ATTEST:


Executive Director


Commissioner

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 96-126 DATED AUGUST 11, 1997

The following rates and charges are prescribed for the customers in the area served by Mountain Water District. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

Monthly Rates:

5/8 x 3/4-Inch Meter

First	2,000	Gallons	\$17.90	Minimum Bill
Next	8,000	Gallons	5.95	Per 1,000 Gallons
All Over	10,000	Gallons	5.16	Per 1,000 Gallons

1-Inch Meter

First	5,000	Gallons	\$35.75	Minimum Bill
Next	5,000	Gallons	5.95	Per 1,000 Gallons
All Over	10,000	Gallons	5.16	Per 1,000 Gallons

2-Inch Meter

First	20,000	Gallons	\$117.10	Minimum Bill
All Over	20,000	Gallons	5.16	Per 1,000 Gallons

3-Inch Meter

First	30,000	Gallons	\$168.70	Minimum Bill
All Over	30,000	Gallons	5.16	Per 1,000 Gallons

4-Inch Meter

First	50,000	Gallons	\$271.90	Minimum Bill
All Over	50,000	Gallons	5.16	Per 1,000 Gallons

6-Inch Meter

First	100,000	Gallons	\$529.90	Minimum Bill
All Over	100,000	Gallons	5.16	Per 1,000 Gallons

Wholesale Rate for Martin County
Water District

\$1.80 Per 1,000 Gallons

Line Leak Adjustment Rate

\$3.29 Per 1,000 Gallons

A surcharge of \$0.45 per 1,000 gallons for a period not to exceed 3 years, or until \$831,675 has been collected, may be assessed after one year from the date of this Order.