

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF DOE VALLEY UTILITIES, INC.)	
FOR A CERTIFICATE OF CONVENIENCE AND)	CASE NO.
NECESSITY FOR CONSTRUCTION AND)	2002-00353
FINANCING AN UPGRADE TO WATER)	
TREATMENT FACILITIES)	

O R D E R

On September 26, 2002, Doe Valley Utilities, Inc. (Doe Valley), a wholly-owned subsidiary of Doe Valley Association, Inc., the property owner s association (POA), filed an application to construct \$1,200,000 in water treatment facility improvements. The improvements include construction of a membrane filtration system, an upgrade to existing raw water pumping facilities, expansion of the treatment plant building, construction of a 30,000 gallon clearwell, replacement of existing high service pumps, and installation of a new 6-inch raw water line. In support of its application Doe Valley submitted:

Appendix A	Articles of Incorporation
Appendix B	Report of GRW Engineers, Inc. dated March 2000 and a 20 year feasibility study prepared by the Doe Valley Utilities Study Group
Appendix C	Correspondence from Natural Resources and Environmental Protection Cabinet
Appendix D	A request for relief from the filing requirements of 807 KAR 5:001, Sections 6 and 11
Appendix E	Operational Costs

At Appendix D Doe Valley stated that POA is financing the proposed project and that POA members have been levied a special assessment to repay the loan. Doe Valley requested relief from the filing requirements of 807 KAR 5:001, Sections 6 and 11, stating that Doe Valley was neither funding the project nor guaranteeing the loan.

By letter dated October 11, 2002, Doe Valley was notified that its filing was deficient pursuant to 807 KAR 5:001, Section 9(2)(b), (c) and (d), and KRS 322.340. Doe Valley cured these deficiencies on December 23, 2002 with a supplement to its original application.

On December 2, 2002, Joe Dooley requested intervention. Mr. Dooley, a resident of the Doe Valley development, was a member of the Doe Valley Utilities Study Group that prepared the 20-year feasibility study as included in the original application at Appendix B. He states that the proposed membrane treatment facility is not the most efficient, economical or practical solution to Doe Valley's supply deficiencies. By Commission Order of January 31, 2003, Mr. Dooley was granted intervention.

On February 18, 2003, the Commission entered an Order to gather additional information and establish a procedural schedule. Doe Valley submitted its responses on March 10, 2003. Included in those responses as a part of Exhibit 4 was the first page of a mortgage agreement between Doe Valley and Bank One. This agreement was evidence that indebtedness of the utility itself, as described in KRS 278.300, was contemplated, contrary to the statements of financing made in the original application. Accordingly, the proposed financing requires Commission approval.

By Order dated March 14, 2003, the Commission suspended the procedural schedule of February 18, 2003 and granted Doe Valley 15 days to amend its original application to comply with KRS 278.300 and all applicable regulations.

On April 1, 2003, Doe Valley amended its application pursuant to Commission directive. The amendment satisfied all filing requirements and included the mortgage agreement dated December 13, 2002 between Doe Valley and Bank One. The mortgage secured repayment of a 5-year, \$1,203,859.98¹ promissory note in the name of POA with an annual rate of interest of 3.75 percent. Based on the terms of the note the monthly payment is \$22,035 or \$264,420 annually once the draw period ends. The total 5-year payment on the note would then be \$1,322,100 (\$264,420 x 5 years). These amounts do not include interest payments required during the draw period which will be assessed at an interest rate of 1.25 percentage points under the Prime Rate as applied to the outstanding balance of the borrow funds.

KRS 278.300(1) states that [n]o utility shall 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 until it has been authorized so to do by order of the commission. The mortgaging of utility property assuredly is an assumption of obligation or liability. Accordingly, any such obligation entered into by Doe Valley without prior approval of the Commission would be null and void.

¹ Doe Valley's response to Commission's Order dated February 18, 2003, Exhibit 4.

To repay the note, POA approved on June 14, 2002 a special assessment of \$17 per lot on a quarterly basis beginning October 1, 2002.² At that time POA expressed concern regarding collecting the assessment.³

A billing statement dated October 1, 2002 reveals that the actual assessment is \$17 per lot per month.⁴ To properly retire the debt POA would be required to successfully collect the assessment from at least 1,297 lots (\$1,322,100 minimum cost of debt / 5 years / 12 months / \$17 per lot) for 5 years. Mr. Dooley stated that there are 1,183 total lots, of which 61 are abandoned. He further stated that an individual owns 544 lots,⁵ making that individual's total contribution toward the debt retirement \$554,880 over the 5-year period (\$17 per lot assessment x 544 lots x 12 months x 5 years) or \$110,976 annually. Mr. Dooley further stated that this individual has refused to pay the assessment and that POA is preparing a lawsuit against this individual in that regard.

Doe Valley's water and sewer divisions 2002 annual reports submitted to the Commission reported the following income statement information:

	Water	Sewer	Total
Operating Revenues	\$145,714	\$51,863	\$197,577
Operating Expenses	(273,079)	(128,024)	(401,103)
Interest Income	1,870	5,373	7,243
Availability Fee Revenue	<u>94,069</u>	<u>48,943</u>	<u>143,012</u>
Net Income / (Loss)	<u>\$(31,426)</u>	<u>\$(21,845)</u>	<u>\$(53,271)</u>
Number of Customers	585	585	

² Id., Exhibit 3.

³ Id., Exhibit 3, Page 2, Section 4.B.

⁴ Complaint filed by Joe Dooley with the Commission on February 10, 2003, Exhibit 3.

⁵ Id., Exhibit 4.

After reviewing the income statement information shown above, the Commission is of the opinion that Doe Valley does not possess the financial viability to guarantee the annual payment of \$264,420 in the event of default by POA. Therefore, the financing portion of the application should be denied.

The evidence of record is sufficient to indicate that the probability of POA collecting the \$17 assessment in a timely manner is low; however, the impact of default by POA on Doe Valley's water customers would be so great that this Commission could not approve the proposed financing even if the probability of timely collection were high.

The construction portion of Doe Valley's application was supported by a GRW Engineering report dated March 2000 and a report prepared by Doe Valley Utilities Study Group dated May 17, 2001.

The GRW report evaluated the condition of the existing treatment facilities, Doe Valley's future needs, Doe Valley's ability to provide quality water and alternatives for producing quality water. The report included five alternatives regarding source of supply: (1) Conventional Surface Water Treatment; (2) Conventional Ground (Well) Water Treatment; (3) Membrane Treatment of Surface Water; (4) Purchased Water from the city of Brandenburg; and (5) Purchased Water from Meade County Water District.

GRW performed a Present Worth analysis for each alternative based on anticipated construction costs and operational costs once the project was completed.

The Present Worth for each alternative was determined to be:

Conventional Surface Water Treatment	\$2,339,557
Conventional Ground (Well) Water Treatment	1,918,094
Membrane Treatment of Surface Water	2,725,406
Purchased Water from the city of Brandenburg	1,993,699
Purchased Water from Meade County Water District	2,734,811

Only the alternative of purchasing water from Meade County Water District produced a higher Present Worth than the membrane facility proposed in Doe Valley's application. However, in reviewing the evidence of this case, the Commission has determined that the Present Worth of the Meade County Water District alternative was overstated in the GRW report. To calculate the Present Worth GRW utilized a purchased water rate from Meade County Water District of \$2.33 per thousand gallons. The record indicates that Meade County Water District will sell water to Doe Valley for \$1.50⁶ per thousand gallons. The difference in the wholesale rate would have a significant impact on the Present Worth calculation. In light of this information it appears that based on the GRW report, Doe Valley has selected the alternative (membrane technology) with significantly higher cost than any other alternative.

GRW's recommendation and conclusion was that Doe Valley limit its serious consideration of water supply and treatment alternatives to the construction of a ground (well) water treatment plant and the purchase of water from the city of Brandenburg.

To evaluate the GRW report more thoroughly the Commission requested evidence substantiating the cost information included therein. Doe Valley was unable to

⁶ Doe Valley's response to Commission's Order dated February 18, 2003, Exhibits 10 and 11.

supply the requested information, stating that it no longer had a working relationship with GRW.⁷

The Doe Valley Utilities Study Group was formed on November 7, 2000 to research all sources of supply available to Doe Valley and recommend a solution. The group included 9 individuals, 7 of whom were residents of Doe Valley.⁸

The group analyzed 5 options: (1) conventional plant expansion; (2) Membrane technology; (3) wells; (4) purchased water from the city of Brandenburg; and (5) purchased water from Meade County Water District. The study projected construction costs for each alternative as follows:

Conventional Treatment Facility	\$500,000
Membrane Treatment Facility	900,000
Wells	700,000 or 500,000
Purchase from the city of Brandenburg	700,000
Purchase from Meade County Water District	200,000

The study did not detail the estimated cost of operation after construction. It did calculate the estimated effect of each alternative on the average monthly customer bill but did not explain how that information was determined. Also, in reviewing the report, the Commission determined that the study group apparently did not utilize the wholesale water purchase rate of \$1.50 per thousand gallons from Meade County Water District but instead used the same \$2.33 shown in the GRW report.

⁷ Id., Item 9.

⁸ Doe Valley s Application, Appendix B, Water Feasibility Study for the Next 20 Years, page 2.

The group summarized its findings in a report and recommended that Doe Valley expand its water treatment facility to a conventional plant producing 350,000 gallons per day and that membrane treatment be considered in the future if cost can be reduced.

Doe Valley's application in this case for a certificate of convenience and necessity to construct the proposed facilities is not supported by the record and the Commission finds that it should be denied. To support its application Doe Valley presented reports prepared by GRW and the study group. Neither report recommended that Doe Valley construct the membrane facility.

The GRW report recommended that Doe Valley give serious consideration only to the alternatives of the ground water treatment plant and water purchased from the city of Brandenburg. The GRW report also stressed that Doe Valley would realize major benefits by purchasing wholesale water as drinking water regulations become more strenuous. The alternative of purchasing water from Meade County Water District is misrepresented as the purchased water rate is overstated. Furthermore, none of the calculations included in the GRW report can be substantiated by Doe Valley.

The Doe Valley Utilities Study Group recommended that conventional plant expansion be utilized and membrane technology be considered if costs can be reduced. The estimated construction cost for the membrane facility was stated at \$900,000 in the report. The cost of the plant improvements included in Doe Valley's application is \$1,200,000. In addition, this study did not provide meaningful information on projected operating costs for each alternative.

The Commission is aware that Doe Valley is operating at or beyond plant capacity. In its 2002 annual report Doe Valley states its peak day demand at 197,000

gallons while its plant capacity is rated at 180,000 gallons per day. This indicates that Doe Valley's existing treatment facility is not able to meet its customers' maximum consumption requirements as required by 807 KAR 5:066, Section 10(4).

To address this issue the Commission finds that Doe Valley should:

1. Perform additional study of purchasing water from Meade County Water District utilizing the purchased water rate of \$1.50 per thousand gallons. If Meade County Water District has the hydraulic capabilities to serve Doe Valley, it is the Commission's opinion that this option should be the most feasible solution, as the projected construction costs of \$192,000 are substantially less than any other option and operating expenses should significantly decrease due to the elimination of most water treatment expenses.

2. Incorporate the analysis referred to in Item 1 above into the GRW feasibility study, substantiate all the costs included in the GRW study, and resubmit an application to construct the facilities that are found to be most cost effective and feasible.

3. As an alternative to Items 1 and 2, perform a new feasibility study analyzing all sources of supply options. This study shall include, at a minimum: (1) all the options included in the previous studies; (2) a detailed analysis of current expenses and the impact each option would have on each expense account; (3) a detailed analysis of all projected operating expenses and construction costs with supporting documentation for each; and (4) the methods available for financing the various options and the impact each would have on the utility's ratepayers. The Commission will not

approve the construction of the membrane facility proposed in this case as long as it is not the most feasible solution.

Having considered the evidence of record and being otherwise sufficiently advised, the Commission HEREBY ORDERS that:

1. Doe Valley s application for financing of the proposed project is denied.
2. Doe Valley s application for a certificate of convenience and necessity to construct the proposed facilities is denied.
3. The mortgage and security agreements dated December 13, 2002 entered into between Bank One and Doe Valley are null and void.
4. Within 90 days from the date of this Order, Doe Valley shall submit a written summary as to its status and position on resolving its source of supply deficit.

Done at Frankfort, Kentucky, this 1st day of May, 2003.

By the Commission

ATTEST:


Executive Director