

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC TARIFF FILING OF THE CITY OF)	
LANCASTER TO INCREASE THE WHOLESALE)	CASE NO.
RATE CHARGED TO GARRARD COUNTY)	2023-00424
WATER ASSOCIATION)	

ORDER

On December 11, 2023, pursuant to 807 KAR 5:011, the city of Lancaster, Kentucky (Lancaster) tendered a tariff proposing to increase its existing rate for wholesale water service to Garrard County Water Association (Garrard Water) in three phases, effective January 11, 2024, January 1, 2025, and January 1, 2026. By Order dated January 5, 2024, pursuant to KRS 278.190(2), the Commission determined that further proceedings were necessary and suspended the rates for five months, up to and including June 10, 2024, and established a procedural schedule to be followed in the case. By Order dated April 5, 2024, the Commission amended the procedural schedule and granted Garrard Water intervention in the matter. Lancaster responded to two requests for information from Commission Staff.¹ It also responded to one request for information from Garrard Water.² Garrard Water also submitted testimony in the case.³ On

¹ Lancaster's Response to Commission Staff's First Request for Information (Staff's First Request) (filed Jan. 19, 2024). Lancaster's Response to Commission Staff's Second Request for Information (Staff's Second Request) (filed Mar. 15, 2024).

² Lancaster's Response to Garrard County Water Association Request for Information (Garrard Water Request) (filed May, 2, 2024).

³ Direct Testimony of Sean Smith, General Manager on Behalf of the Garrard Water (Smith Direct Testimony) (filed June 6, 2024).

September 5, 2024, Garrard Water filed a motion to submit the matter on the record. Lancaster also filed a request for the matter to be submitted on the record.⁴ This matter now stands submitted to the Commission for a decision.

LEGAL STANDARD

Pursuant to KRS 278.200, the Commission has jurisdiction over rates and services that are fixed by contract between a utility subject to the Commission's jurisdiction and a city, such as Lancaster. The Supreme Court's decision in *Simpson County Water District v. City of Franklin* specifically stated that "where contracts have been executed between a utility and a city . . . KRS 278.200 is applicable and requires that by so contracting the City relinquishes the exemption and is rendered subject to the PSC rates and service regulation."⁵ Following the Court's decision in *Simpson County*, the Commission has allowed city-owned utilities to file rate adjustments by a tariff filing. If a hearing is requested or the Commission suspends the proposed rate, the requirements and procedures set forth in KRS Chapter 278, and the Commission's regulations, apply equally to filings by a city-owned utility or a jurisdictional utility.⁶

Lancaster's wholesale water rate charged to Garrard Water is subject to KRS 278.030, which provides that a utility may collect fair, just and reasonable rates. KRS 278.260 explains that the Commission may, on its own motion, investigate whether "any regulation, measurement, practice or act affecting or relating to the service of the

⁴ Lancaster's Motion to Submit on the Record (filed Sept. 6, 2024).

⁵ *Simpson County Water District v. City of Franklin*, 872 S.W.2d 460, 463 (Ky. 1994).

⁶ *Simpson County Water District v. City of Franklin*, 872 S.W.2d 460, 463 (Ky. 1994); *City of Danville v. Public Service Comm'n, et al.*, Civil Action No. 15-CI-00989, Opinion and Order (Franklin Circuit Court Division II, June 14, 2016).

utility or any service in connection therewith is unreasonable.” Thus, in accordance with KRS 278.030, KRS 278.200, and KRS 278.260, the Commission must determine whether Lancaster’s proposed rate increase is fair, just and reasonable based upon the evidentiary record.

BACKGROUND

Lancaster’s current wholesale water rate to Garrard Water is \$2.49 per 1,000 gallons for the first 325,000,000 gallons, which is Garrard Water’s minimum annual purchase. The current rate for amounts in excess of 325,000,000 gallons per year is \$1.40 per thousand gallons.⁷ Lancaster calculated a minimum wholesale rate of \$3.75, a 50.60 percent increase, and an incremental rate for volume over the minimum of \$2.11, a 50.71 percent increase.⁸ Lancaster requested a three-phase implementation of its proposed wholesale water rates as shown in the Figure 1 below.⁹ The Commission notes that, when Lancaster calculated the proposed increase over three years, it applied each increment to the previous rate rather than applying the accumulated increase against the base rates of \$2.49 per thousand gallons for the minimum and \$1.40 per thousand gallons for the incremental rate. The result, as calculated by Lancaster, is that the Phase 3 rate of \$3.97 for the minimum purchases exceeds the calculated rate of \$3.75 by \$0.22 per thousand gallons or 5.87 percent.

⁷ P.S.C. Ky. No. 2nd Revised, Sheet No. 1 (issued Feb. 3, 2022), effective Mar. 10, 2022.

⁸ Lancaster Tariff Filing (filed Dec. 21, 2023) , 20231211_City-of-Lancaster_2023_Water_Wholesale_Rate_Model.xlsx, Worksheet: Revenue Required Computation, cells H56 and H57.

⁹ Lancaster Tariff Filing.

Figure 1
*Lancaster Proposed Wholesale Rates (Phase 1, 2, 3) Compared to Current Tariff and Calculated Wholesale Rate
Including Depreciation*

Phase	Effective Date	Requested Amount (first 325 million annual gallons) /		Incremental Rate (over 325 million annual gallons) /	
			Percent vs. Base		Percent vs. Base
	Mar. 10, 2022 (base rate)	\$	2.49	\$	1.40
	Lancaster's Calculated Wholesale Rate	\$	3.75	50.60%	50.71%
1	January 11, 2024 (proposed rate)	\$	2.91	16.87%	17.14%
2	January 1, 2025 (proposed rate)	\$	3.40	16.84%	17.07%
3	January 11, 2026 (proposed rate)	\$	3.97	16.76%	16.67%
	Cumulative Percent of Base Rate			59.44%	60.00%
	Cumulative Percent vs. Calculated Rate			5.87%	6.16%

Lancaster stated in its response to Staff's First Request that the method for calculating rates for both wholesale and retail customers was the same and that it was based on operating expenses, depreciation expenses, and debt service.¹⁰ It further stated that the Lancaster City Council requested an alternative for its consideration based on operating expenses and debt service only and that, after consideration, the Council adopted wholesale rates that included depreciation expenses and retail rates that excluded depreciation expenses.¹¹ It stated that there were no other differences in the calculation methods between the retail and wholesale customers.¹² Lancaster provided its calculated wholesale rates excluding depreciation as shown in Figure 2 below in response to Staff's Second Request.¹³

¹⁰ Lancaster's Response to Staff's First Request, Item 2.

¹¹ Lancaster's Response to Staff's First Request, Item 2.

¹² Lancaster's Response to Staff's First Request, Item 2.

¹³ Lancaster's Response to Staff's Second Request, Item 3.

Figure 2
*Lancaster Proposed Wholesale Rates (Phase 1, 2, 3) Compared to Current Tariff and Calculated Wholesale Rate
Excluding Depreciation*

Phase	Effective Date	Requested Amount (first 325 million annual gallons) / Percent		Incremental Rate (over 325 million annual gallons) / Percent	
	Mar. 10, 2022 (base rate)	\$	2.49	\$	1.40
	Lancaster's Calculated Wholesale Rate	\$	2.91	\$	1.64
1	January 11, 2024 (proposed rate)	\$	2.63	5.62%	5.71%
2	January 1, 2025 (proposed rate)	\$	2.78	5.70%	5.41%
3	January 11, 2026 (proposed rate)	\$	2.94	5.76%	5.77%
	Cumulative Percent of Base Rate		18.07%		17.86%
	Cumulative Percent vs. Calculated Rate		1.03%		0.61%

Lancaster responded to Garrard Water that it expects that infrastructure investments that benefit only its retail system will be paid from the city of Lancaster Funds and that investments that benefit both its retail and wholesale customer will be paid proportionately from the city of Lancaster funds and depreciation funds.¹⁴ Lancaster further stated that, as a home rule-class city, it has the statutory authority to set public policy for how it will pay its proportional share of water system infrastructure investments.¹⁵

Garrard Water explained that it intervened in the case in the interest of advocating for fair treatment among Lancaster’s wholesale and retail customers on behalf of Garrard Water’s customers because the rate will affect its customers.¹⁶ Garrard Water specifically requested the Commission to determine whether the rates proposed that include depreciation for the wholesale customers but do not for its retail customers are fair, just and reasonable.¹⁷

¹⁴ Lancaster’s Response to Garrard Water Request for Information, Item 1.

¹⁵ Lancaster’s Response to Garrard Water Request for Information, Item 1.

¹⁶ Direct Testimony of Sean Smith (Smith Direct Testimony) (filed June 6, 2024) at 3.

¹⁷ Smith Direct Testimony at 3.

DISCUSSION

Based on the evidence in the record, the Commission finds that Lancaster and Garrard Water's motion to submit the case on the record is granted. The Commission finds that the calculated rate amounts both including and excluding depreciation are reasonable. However, while the inclusion, and recovery, of depreciation expense in the calculation of rates is reasonable, recovering depreciation from one class of customers and not the other is not.

Upon review of the record the Commission identified issues with two items requiring correction. First, the application of the proposed methodology to calculate the third year of the phased rates is contrary to the record because the proposed Phase 3 rate exceeds the calculated rate in Lancaster's analysis.¹⁸ The Commission notes that when Lancaster divided the increase over three years, it applied each increment to the previous rate rather than applying the accumulated increase against the base rates of \$2.49 per thousand gallons for the minimum and \$1.40 per thousand gallons for the incremental rate. The result is that the Phase 3 rate of \$3.97 for the minimum purchases exceeds the calculated rate of \$3.75 by \$0.22 per thousand gallons or 5.87 percent. The Commission finds that Lancaster has met its burden as to the increase in rates needed to satisfy its obligations; however, the calculation of the increase must then reflect the same information. As noted in Figure 2 above, the Commission finds that fair, just and reasonable rates require the Commission to approve mathematically correct rates.

¹⁸ Lancaster's Response to Staff's First Request, Exhibit 1, Exhibit_1_-_Water_Retail_Rate_Model.xlsx.

While Lancaster's rate study recognizes that depreciation is a valid component of the ratemaking process and it properly allocated the cost to all customers, Lancaster's proposed rate increase excluded depreciation expense from the rate calculation for retail customers, while including the same for wholesale customers.¹⁹ The Commission finds that Lancaster's proposed wholesale tariff is not fair, just, and reasonable because Lancaster's application of its rate calculations is not consistent. In addition, the Commission finds that Lancaster did not present sufficient evidence to justify the disparate treatment between customer classes. When addressing the issue in response to a request for information from Commission Staff, Lancaster provided no analysis or calculation to support its assertions that the removal of depreciation from retail rates was appropriate.²⁰

The Commission finds Lancaster's proposal to phase in rates is reasonable. The phase-in approach is used to reduce the rate shock an increase may have if implemented all at once. The Commission recognizes that, when calculated appropriately, the phase-in approach is appropriate in this case.

IT IS THEREFORE ORDERED that:

1. Garrard Water and Lancaster's motions to submit the matter on the record are granted.
2. The wholesale rates proposed by Lancaster for service to Garrard Water are denied.

¹⁹ Lancaster's Response to Staff's First Request, Item 2.

²⁰ Lancaster's Response to Staff's Second Request, Item 2.

3. The wholesale rates in the Appendix to this Order are approved for service rendered on and after the date of this Order.

4. Within 20 days of the date of service of this Order, Lancaster shall file with the Commission, using the Commission's electronic Tariff Filing System, its revised tariff sheet setting forth the rates approved herein and reflecting their effective dates and that they were authorized by this Order.


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

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PUBLIC SERVICE COMMISSION



Chairman



Commissioner



Commissioner



ATTEST:



Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2023-00424 DATED SEP 26 2024

Monthly Wholesale Water Rate

Phase 1

First	325,000,000 Gallons	\$	0.00263	per Gallon
Over	325,000,000 Gallons		0.00148	per Gallon

Phase 2

To Be Implemented One Year After Phase 1 Rates

First	325,000,000 Gallons	\$	0.00278	per Gallon
Over	325,000,000 Gallons		0.00156	per Gallon

Phase 3

To Be Implemented One Year After Phase 2 Rates

First	325,000,000 Gallons	\$	0.00291	per Gallon
Over	325,000,000 Gallons		0.00164	per Gallon

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