

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF BIG SANDY WATER DISTRICT )  
FOR AN ADJUSTMENT IN RATES PURSUANT TO ) CASE NO. 2012-00152  
THE ALTERNATIVE RATE FILING PROCEDURE )  
FOR SMALL UTILITIES )

ORDER

Overland Development Inc. (“Overland Development”) has sought rehearing of the Commission’s Order of August 24, 2012 in which we adjusted the rates of Big Sandy Water District (“Big Sandy District”), including the rates for its wholesale water service to Overland Development. Overland Development’s request presents the following issue: Are the principles of rate gradualism violated when a water utility increases its wholesale rate 34.38 percent but increases its retail rates only 6.47 percent? Finding in the affirmative, we modify the rates established in our Order of August 24, 2012.

Big Sandy District, a water district organized pursuant to KRS Chapter 74, owns and operates facilities that distribute water to approximately 4,538 customers in Boyd, Carter, Johnson, and Lawrence counties, Kentucky.<sup>1</sup> It also provides wholesale water service to Overland Development and Cannonsburg Water District.<sup>2</sup> Big Sandy District

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<sup>1</sup> *Annual Report of Big Sandy Water District to the Public Service Commission for the Calendar Year Ended December 31, 2011* at 5 and 27.

<sup>2</sup> *Id.* at 29.

purchases its water requirements from Cannonsburg Water District, Rattlesnake Ridge Water District, the city of Louisa, Kentucky, and the city of Kenova, West Virginia.<sup>3</sup>

Prior to this proceeding, Big Sandy District's last general rate adjustment occurred in 1985.<sup>4</sup> Big Sandy District has adjusted its rates since then but has used the purchased water adjustment procedure<sup>5</sup> or adjusted its rates as part of a financing agreement with Rural Development.<sup>6</sup> In those proceedings, we did not conduct any review of the design of Big Sandy District's rates.<sup>7</sup>

Overland Development, a Kentucky corporation organized under KRS Chapter 271B, owns and operates facilities that distribute water to 112 customers in Boyd

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<sup>3</sup> *Id.*

<sup>4</sup> Case No. 9156, *An Adjustment of the Rates of Big Sandy Water District* (Ky. PSC May 13, 1985).

<sup>5</sup> Case No. 96-021, *Purchased Water Adjustment of Big Sandy Water District* (Ky. PSC Mar. 1, 1996); Case No. 99-440, *Purchased Water Adjustment of Big Sandy Water District* (Ky. PSC Nov. 24, 1999); Case No. 2002-00330, *Application of Big Sandy Water District for a Purchased Water Adjustment* (Ky. PSC Oct. 14, 2002); Case No. 2006-00200, *Application of Big Sandy Water District for a Purchased Water Adjustment* (Ky. PSC June 6, 2006); Case No. 2007-00091, *Purchased Water Adjustment of Big Sandy Water District* (Ky. PSC Mar. 27, 2007); Case No. 2008-00434, *Purchased Water Adjustment of Big Sandy Water District* (Ky. PSC Oct. 30, 2008); Case No. 2008-00487, *Purchased Water Adjustment of Big Sandy Water District* (Ky. PSC Dec. 18, 2008); Case No. 2009-00153, *Purchased Water Adjustment of Big Sandy Water District* (Ky. PSC May 1, 2009); Case No. 2009-00181, *Purchased Water Adjustment of Big Sandy Water District* (Ky. PSC June 8, 2009); Case No. 2009-00402, *Purchased Water Adjustment of Big Sandy Water District* (Ky. PSC Nov. 4, 2009); Case No. 2010-00105, *Purchased Water Adjustment of Big Sandy Water District* (Ky. PSC Apr. 4, 2010); Case No. 2010-00483, *Purchased Water Adjustment of Big Sandy Water District* (Ky. PSC Jan. 10, 2011); Case No. 2011-00373, *Purchased Water Adjustment of Big Sandy Water District* (Ky. PSC Oct. 10, 2011); Case No. 2012-00012, *Purchased Water Adjustment of Big Sandy Water District* (Ky. PSC Feb. 3, 2012); Case No. 2012-00161, *Purchased Water Adjustment of Big Sandy Water District* (Ky. PSC May 18, 2012).

<sup>6</sup> Case No. 89-333, *The Application of Big Sandy Water District of Boyd, Carter and Lawrence Counties, Kentucky, for an Order Approving Construction, Financing and Certificate of Public Convenience and Necessity* (Ky. PSC Nov. 22, 1989).

<sup>7</sup> KRS 278.015 permits a water district to adjust without prior Commission approval its rates to reflect changes in the rate of its water supplier. The Commission's review of such adjustments is limited to determining whether the rate adjustment is commensurate with the wholesale supplier's adjustment. No other factors are considered. See also 807 KAR 5:068. KRS 278.023 expressly provides that, if a construction project undertaken by a water district is financed under the terms of an agreement between the water district and the United States Department of Agriculture, the Commission **must** accept the terms of that agreement and take all action necessary to implement the terms of that agreement, including approving the rates for service that such agreement requires the water district to assess.

County, Kentucky.<sup>8</sup> It has been in operation since 1970. Overland Development purchases its total water requirements from Big Sandy District. It executed a water purchase contract with Big Sandy in December 1986. This contract provided for water service through a 3-inch meter and required Overland to pay a minimum bill of \$530.30 per month, plus a flat volumetric charge of \$0.38 per 1,000 gallons of water. Overland Development and Big Sandy have executed several amendments to this contract. The most recent contract requires Overland Development to pay a minimum monthly charge of \$545.75 and a volumetric charge of \$1.25. The contract further provides that Big Sandy District may adjust the rate to pass through any increases in the cost of purchased water.<sup>9</sup>

On April 24, 2012, Big Sandy District applied for a general rate adjustment using the Alternative Rate Filing Procedure. On August 24, 2012, the Commission issued an order in which we established rates that would produce additional annual revenues of \$119,436, or a 5.06 percent increase over normalized test-period revenues from water sales of \$2,361,476. These rates increased the monthly bill of an average customer from \$32.90 to \$35.03, or approximately 6.47 percent. We further established a unified wholesale rate of \$4.65 per 1,000 gallons and eliminated the previous wholesale rate that Big Sandy District assessed to Overland Development.<sup>10</sup> This rate effectively increased Overland Development's annual water cost from \$25,168 to \$33,819, or 34.4 percent.

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<sup>8</sup> *Annual Report of Overland Development, Inc. to the Public Service Commission for the Calendar Year Ended December 31, 2011* at 5 and 24.

<sup>9</sup> See Water User Agreement – Special Contract at 1-2 (Jun. 1, 2007).

<sup>10</sup> At the time of the Order, this wholesale rate was \$545.75 per month plus \$2.56 per 1,000 gallons of water sold. In contrast, the wholesale rate assessed to Cannonsburg Water District was \$3.22 per 1,000 gallons.

Overland Development petitioned for rehearing on the Order of August 24, 2012.<sup>11</sup> On September 17, 2012, the Commission granted the petition and agreed to rehear two issues: (1) Whether the terms of the wholesale agreement between Overland Development and Big Sandy District could be revised without Overland Development's consent and (2) Whether the increase in the wholesale water service rate violated the principles of gradualism.

As to the first issue, a contract between a utility and a customer does not limit the Commission's authority to review and adjust the rate contained in that contract. *Bd. of Education of Jefferson County v. William Dohrman, Inc.*, 620 S.W.2d 328 (Ky. App. 1981) ("the Commission had the right and duty to regulate rates and services, no matter what a contract provided").<sup>12</sup> The contract between the two utilities does not prohibit or restrict the Commission's authority to establish fair, just and reasonable rates.

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<sup>11</sup> On August 29, 2012, Overland Development requested rehearing of the Commission's Orders of August 22, 2012 and August 24, 2012. By our Order of August 22, 2012, we denied Overland Development's request for intervention in this proceeding as untimely. By our Order of August 24, 2012, we entered a final decision on Big Sandy District's application for rate adjustment and established new rates for water service. On September 17, 2012, we granted Overland Development's petition for rehearing, allowed Overland to intervene in this proceeding, and established a procedural schedule to consider its arguments regarding the reasonableness and lawfulness of the wholesale rates.

<sup>12</sup> See also *National Southwire Aluminum Co. v. Big Rivers Electric Corp.*, 785 S.W.2d 503, 517 (1990) ("Kentucky law generally holds utility contracts are subject to rate changes ordered by the PSC, no matter what the contracts provide."); Case No. 2003-00137, *Kentucky Utilities Company Revised Special Contract With North American Stainless L.P.* (Ky. PSC Oct. 19, 2005) (rejecting arguments that special contracts can be treated differently from generally available rate tariffs); Administrative Case No. 375, *An Investigation into the Design and Use of System Development Charges* (Ky. PSC Sept. 25, 2000) at 6 ("when setting utility rates, the Commission may disregard the terms of utility service contracts"); Case No. 97-377, *City of Jeffersonville v. Montgomery County Water District No. 1* (Ky. PSC Apr. 9, 1998) at 3 ("That the parties have contracted for a certain rate does not immunize the agreed rate from modification."); Case No. 9512, *The Application of the East Clark County Water District, of Clark County, Kentucky, for Approval of Construction, Financing, and Increased Rates* (Ky. PSC Sept. 30, 1986) at 15 ("the Commission's authority to regulate the rates and service standards of public utilities cannot be limited by contractual provisions").

As to the second question, the Commission has long stated that ratemaking should be based upon principles of “rate continuity, stability and gradualism.”<sup>13</sup> We have also indicated that when a conflict between the principles of cost-based rates and a gradual adjustment of rates, the principle of cost-based rates will not always control.<sup>14</sup> Recently we noted its “long-standing practice of employing the principle of gradualism in moving toward cost-of-service-based rates” and stated that “moving to cost-of-service-based rates for all classes is a goal to be achieved gradually, in incremental steps.”<sup>15</sup>

Overland Development argues that the Commission’s decision violates the principles of gradualism. Any alleged disparity between the cost providing service to Overland and the wholesale rate, it argues, has existed for a significant period of time and should be corrected gradually – not at once. By the Commission’s Order, it further argues, the Commission has increased the wholesale rate changed to Overland Development by a much larger percentage than that assessed to Big Sandy District’s

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<sup>13</sup> See, e.g., Case No. 10064, *Adjustment of the Gas and Electric Rates of the Louisville Gas and Electric Company* (Ky. PSC Aug. 10, 1988) at 12.

<sup>14</sup> See, e.g., Case No. 8800, *Notice of Bronston Water Association, Inc., to Increase Its Water Rates* (“The Commission agrees with Bronston that cost causative factors must bear heavily in rate determination and urges Bronston to file a revised cost study with any future application for rate adjustment. However, the Commission is also committed to the principles of gradualism in rate adjustment which would not justify the reduction of rates to some customers while increasing the rates to others by more than 86 percent.”).

<sup>15</sup> Case No. 2011-00036, *Application of Big Rivers Electric Corporation for a General Adjustment of Rates* (Ky. PSC Nov. 17, 2011) at 30.

retail customers. This action will result in a significant increase in the rates for Overland Development's ratepayers<sup>16</sup> and produce rate shock.<sup>17</sup>

The record generally supports Overland Development's position. By our Order of August 24, 2012, we have increased Overland Development's annual cost of water by 34.4 percent while increasing Big Sandy District's retail customers' annual cost by only 5.1 percent. When this increase is passed through to Overland Development's retail customers, a 13 percent increase in the retail rates for those customers occurs. Whether this increase constitutes "rate shock" is unclear. Given that adjustments to Big Sandy District's present rates can be made that will affect the monthly bills of Big Sandy District's retail customers by only a few cents while significantly reducing the wholesale rate increase, a gradual increase in rates to resolve a condition that has existed for almost two decades is more appropriate and consistent with past precedent.

Given Big Sandy District's past use of general rate adjustments, a gradual approach is not easily implemented. Gradualism requires the gradual shifting of costs between customer classes to the class of customer causing the cost. It is premised on the assumption that a utility will make periodic rate adjustments and the shift in costs can gradually be made during these periodic rate adjustments. Big Sandy District has no history of periodic rate adjustments. It has applied for only one general rate adjustment in the past 17 years. Any effort to gradually shift costs to reflect the cost-of-

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<sup>16</sup> 807 KAR 5:069 permits a privately owned water utility to pass through to its customers the increased cost of purchased water due to a wholesale supplier's rate adjustment in an expedited manner. Overland Development recently adjusted its rates pursuant to that regulation to pass through the increased cost of purchased water. See Case No. 2012-00414, *Purchased Water Adjustment Filing of Overland Development Inc.* (Ky. PSC Oct. 5, 2012).

<sup>17</sup> Rate shock is "[t]he presumed psychological effect of a sudden, drastic rate increase." P.U.R. Glossary for Utility Management 118 (Public Utilities Reports, Inc. ed., 1992).

service cannot be based upon Big Sandy District's making periodic applications for general rate adjustment, but must instead be phased in by this Order.

Based upon our review of the record, the Commission finds that:

1. Big Sandy District's rates should be amended to permit a gradual shift to cost-of-service rates for its wholesale customers.

2. The rates set forth in Appendix A to this Order will produce annual revenues from water sales of \$2,480,912, include a wholesale rate that reflects approximately half of the total revenue increase from wholesale customers necessary for Big Sandy District's wholesale rate to reflect the cost of providing wholesale service, and should be assessed for water service that Big Sandy District provides on and after April 1, 2013.<sup>18</sup>

3. The rates set forth in Appendix B to this Order will produce annual revenues from water sales of \$2,480,912, include a wholesale rate that reflects the total revenue increase from wholesale customers necessary for Big Sandy District's wholesale rate to reflect the cost of providing wholesale service, and should be assessed for water service that Big Sandy District provides on and after October 1, 2014.

4. If, before September 1, 2014, any of Big Sandy District's water suppliers increases its rates for water and Big Sandy District's rates are adjusted pursuant to KRS 278.015 to reflect the supplier's increase, the rates set forth in Appendix B should be adjusted to reflect the approved purchased water adjustment.

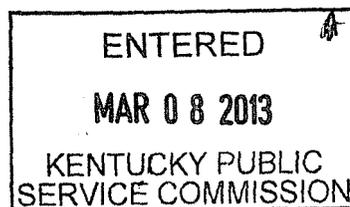
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<sup>18</sup> The rates in Appendices A and B have been adjusted to reflect Big Sandy's recent adjustment due to an increase in the cost of water that it purchases from Cannonsburg Water District. Case No. 2013-00040, *Purchased Water Adjustment of Big Sandy Water District* (Ky. PSC Feb 21, 2013).

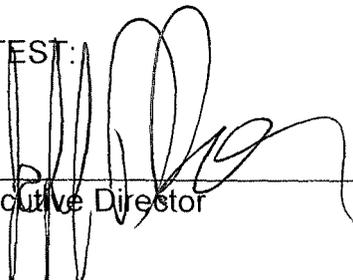
IT IS THEREFORE ORDERED that:

1. Big Sandy District shall assess the rates set forth in Appendix A to this Order for water service rendered on and after April 1, 2013 until September 30, 2014.
2. Big Sandy District shall assess the rates set forth in Appendix B to this Order for water service rendered on and after October 1, 2014.
3. If before October 1, 2014, any of Big Sandy District's water suppliers increases its rates for water and Big Sandy District's rates are adjusted pursuant to KRS 278.015 to reflect the supplier's increase, the rates set forth in Appendix B shall also be adjusted to reflect the approved purchased water adjustment.
4. Within 20 days of the date of this Order, Big Sandy District shall file with the Commission, using the Commission's electronic Tariff Filing System, revised tariff sheets showing the rates approved herein.

By the Commission



ATTEST:

  
Executive Director

## APPENDIX A

### APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2012-00152 DATED **MAR 08 2013**

The following rates and charges are prescribed for the customers of Big Sandy Water District for service rendered on and after April 1, 2013 and until October 1, 2014. All rates and charges not specifically listed shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order

#### 5/8- X 3/4-Inch Meter

First	2,000 Gallons	\$23.51	Minimum Bill
Next	8,000 Gallons	6.20	per 1,000 Gallons
Next	20,000 Gallons	5.72	per 1,000 Gallons
Next	20,000 Gallons	5.30	per 1,000 Gallons
Over	50,000 Gallons	5.07	per 1,000 Gallons

#### 1-Inch Meter

First	10,000 Gallons	\$73.11	Minimum Bill
Next	20,000 Gallons	5.72	per 1,000 Gallons
Next	20,000 Gallons	5.30	per 1,000 Gallons
Over	50,000 Gallons	5.07	per 1,000 Gallons

#### 1 1/2-Inch Meter

First	30,000 Gallons	\$187.51	Minimum Bill
Next	20,000 Gallons	5.30	per 1,000 Gallons
Over	50,000 Gallons	5.07	per 1,000 Gallons

#### 2-Inch Meter

First	50,000 Gallons	\$293.51	Minimum Bill
Over	50,000 Gallons	5.07	per 1,000 Gallons

#### 3-Inch Meter

First	100,000 Gallons	\$547.01	Minimum Bill
Over	100,000 Gallons	5.07	per 1,000 Gallons

#### 4-Inch Meter

First	200,000 Gallons	\$1,054.01	Minimum Bill
Over	200,000 Gallons	5.07	per 1,000 Gallons

Wholesale Service		\$4.39	Per 1,000 Gallons
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APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 2012-00152 DATED MAR 08 2013

The following rates and charges are prescribed for the customers of Big Sandy Water District for service rendered on and after October 1, 2014. All rates and charges not specifically listed shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

5/8- X 3/4-Inch Meter

First	2,000 Gallons	\$23.49	Minimum Bill
Next	8,000 Gallons	6.19	per 1,000 Gallons
Next	20,000 Gallons	5.71	per 1,000 Gallons
Next	20,000 Gallons	5.29	per 1,000 Gallons
Over	50,000 Gallons	5.06	per 1,000 Gallons

1-Inch Meter

First	10,000 Gallons	\$73.01	Minimum Bill
Next	20,000 Gallons	5.71	per 1,000 Gallons
Next	20,000 Gallons	5.29	per 1,000 Gallons
Over	50,000 Gallons	5.06	per 1,000 Gallons

1 1/2-Inch Meter

First	30,000 Gallons	\$187.21	Minimum Bill
Next	20,000 Gallons	5.29	per 1,000 Gallons
Over	50,000 Gallons	5.06	per 1,000 Gallons

2-Inch Meter

First	50,000 Gallons	\$293.01	Minimum Bill
Over	50,000 Gallons	5.06	per 1,000 Gallons

3-Inch Meter

First	100,000 Gallons	\$546.01	Minimum Bill
Over	100,000 Gallons	5.06	per 1,000 Gallons

4-Inch Meter

First	200,000 Gallons	\$1,052.01	Minimum Bill
Over	200,000 Gallons	5.06	per 1,000 Gallons

Wholesale Service		\$4.69	Per 1,000 Gallons
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Mr. Jimmy Blanton  
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