

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

In the Matter of:

PROPOSED ADJUSTMENT OF THE WHOLESALE)
WATER SERVICE RATES OF CENTRAL CITY) Case No. 2019-00260
MUNICIPAL WATER & SEWER)

CENTRAL CITY’S MOTION FOR RECONSIDERATION

The City of Central City, by counsel, respectfully requests that the Commission reconsider its Order dated July 30, 2019, in light of additional information provided herein. Specifically, Central City requests that the Commission approve Central City’s proposed wholesale rate because the Commission has previously indicated its intent not to impair or impede a municipality’s ability to received federal funding for projects. In support of this motion, and as more fully described below, Central City provides additional information to confirm that the project that will be federally funded will assist in providing continued wholesale service, that Central City substantially complied with the procedural provisions of the wholesale contracts, and that the Commission has authority to revise the wholesale rate regardless of the contractual provisions.

I. Background

On June 24, 2019, Central City filed with the Commission a revised tariff sheet setting forth proposed adjustments to its existing rates for wholesale water service to Muhlenberg County Water District and Muhlenberg County Water District #3 (the “Districts”) effective on July 31, 2019. Central City proposed to increase its rates for wholesale water service to \$3.31

per 1,000 gallons based on a condition from the U.S. Department of Agriculture, acting through Rural Development (“RD”), to set minimum rates in order to receive favorable funding.

As mentioned in Central City’s initial filing, it relies on the Commission’s decision in Case No. 2003-00358 involving the City of Harlan’s proposed rate increase for wholesale water service. In that case, the Commission found that, if the Commission ordered Harlan to charge rates less than those specified by RD, Harlan would fail to meet the RD conditions and their ability to receive funding would be impaired. Finding that the Commission did not want to impair or impede Harlan’s ability to receive funding, the Commission approved Harlan’s proposed rates.

In the present case, the Commission has determined that the circumstances of Central City’s proposed rates may differ from those of Harlan’s 2003 proposed rates. Specifically, the Commission indicated that the record is not yet clear on whether Central City’s proposed project is related to the provision of water service to the wholesale customers and whether Central City complied with certain procedural requirements set forth in contracts with the wholesale providers.¹

As will be discussed in more detail below, Central City’s proposed project is directly related to the provision of water service to its wholesale customers, Central City has substantially complied with the procedural requirements set forth in the wholesale contracts, and the Commission has authority to approve increased wholesale rates regardless of the provisions of the contract. And most importantly, Central City’s ability to receive grant and low-interest financing from RD is contingent on approval of the proposed rates. Accordingly, Central City requests that the Commission reconsider its previous ruling based on the additional information presented in this motion and issue an order approving Central City’s approved rates.

¹ See Order dated July 30, 2019, at 3-4.

II. Analysis

A. Central City's proposed project is directly related to the provision of water service to its wholesale customers.

Central City received a favorable review by RD to receive funding for its proposed project. The proposal actually involves several projects, all of which benefit Muhlenberg County Water District and Muhlenberg County Water District #3. Exhibit A to this Motion provides a detailed description of the projects, as explained by McGhee Engineering. Here is a brief summary:

1. Refurbish and Repaint Reservoir Hill Tank No. 2 - The interior and exterior coatings of Reservoir Hill Tank No. 2 are deteriorated and need refurbishing. This tank is one of three tanks in Central City's system that is generally always in service. These tanks provide storage for treated water and serve to mitigate pressure fluctuations in the system resulting from varying demands. Having this storage volume available is one of the factors that allows the Districts to take water on their schedule.
2. Install Tank Mixing Systems in Reservoir Hill 1 & 2 and Rose Hill Tanks – Installation of these mixing systems will balance the effective age of the water in Central City's system. This will help lessen the formation of disinfection byproducts (DBP) and assist with compliance with regulatory limits on trihalomethane and haloacetic acid concentrations in the finished water. Lowering DBP levels benefits all water customers, but since DBP levels tend to be highest in the most distant parts of the distribution system, adding the mixing systems is of most benefit to the Districts.
3. Replace Intake Sluice Gates – Sluice gates are submerged in the river within the intake structure. These gates are inoperable, and their location in the river makes them inaccessible for maintenance and repairs by plant personnel. There is a risk that an extended drought could lower the river level to a point that water could not flow into the intake. This would jeopardize water availability to all customers supplied by the Central City plant, including the Districts. Replacement of these gates would help ensure continued service to all customers, including the Districts.
4. Clean and Replenish Filter Media at the Water Treatment Plant - Granular filter media requires periodic cleaning and replenishment. Some of the older filters need

this work. Filtration is central to the water treatment process and affects all system users.

5. Renovate Laboratory at the Water Treatment Plant - The laboratory at the water treatment plant is original to the plant. The cabinetry and plumbing are deteriorated and largely unrepairable due to obsolescence. This work would replace the cabinetry, plumbing, and non-functional or obsolete equipment. The laboratory is integral to the treatment process by providing needed plant performance and compliance data, and benefits all users, including the Districts.
6. Valve Replacement at Reservoir Hill Tanks - Some of the buried valves used to direct flow between and isolate tanks are non-functional and require replacement. Work on these tanks benefits all customers as described in item 1 above.
7. Demolish Stringtown Tank – In 2014, the Stringtown Tank was found to be badly deteriorated and to have a non-compliant interior coating system. It was removed from service. The demolition of the tank is intended to remove a non-functioning asset that will pose an increasingly significant liability risk as the deterioration continues. As such, the demolition benefits all customers.
8. Equipment Storage Building at Water Treatment Plant - There is minimal storage space for equipment, spare parts, and supplies at the existing water treatment plant, causing some items to have to be stored outside. There is also limited workshop space for performing equipment repairs and maintenance. This affects the expected life of the equipment, and makes it more difficult to access and use, particularly during inclement weather. The intent is to provide a garage-like structure to house equipment and a work area. This will improve the service life of the equipment and supplies, and improve and enhance maintenance of the plant, which will benefit all customers.
9. Replace Bulk Doors at Building 75 at the Water Treatment Plant - Building 75 was formerly the gas chlorine storage facility. It has now been converted to liquid storage for chemicals used in the treatment process. It is equipped with two large, heavy steel doors that are badly deteriorated and obsolete. By replacing the bulk doors at this site, the operability of the chemical storage system will be enhanced. All work at the treatment plant benefits all customers because the plant is necessary to providing treated water to all customers, including the District.
10. SCADA Enclosures at Reservoir and Rose Hill Tanks – In 2012, SCADA equipment was installed in weatherproof cabinets, but if maintenance or adjustment of the

equipment is required during rains, the equipment in the cabinets can be damaged. The intent is to provide a small canopy over the cabinets to protect them from rain. This will enhance operability of the distribution storage system and will benefit all customers.

11. Non-Construction Costs and Contingency – As with any project, non-construction costs and contingencies are included in the project budget. These expenses correlate to the various projects discussed above, each of which benefits the Districts.

These projects are necessary to the continued operation of Central City’s system and important to providing safe, reliable service to Muhlenberg County Water District and Muhlenberg County Water District #3. RD has indicated its willingness to fund the projects if certain contingencies are met, including the minimum wholesale rate to be set at \$3.31 per 1,000 gallons. This funding includes \$150,000 of grant money. If Central City’s wholesale rate is not set at \$3.31 per 1,000 gallons or higher, Central City will not meet the conditions set forth by RD, will not receive favorable funding, and will not be able to complete these projects.

B. Central City has substantially complied with the contractual provisions of the wholesale water agreements.

In its Order dated, July 30, 2019, the Commission indicated that it was unclear from the record before it whether Central City complied with the contractual provisions of the wholesale contracts between the City and the Districts. It appears that the Commission seeks clarity in the record on Central City’s actions as they relate to paragraphs 13, 14, 15, and 16 of the contracts. As will be discussed below, Central City has substantially complied with the procedural provisions of the contracts, and the Commission has authority to increase rates set by contract regardless of the other provisions in the contract.

Paragraph 13 of the contracts states that Central City “shall utilize a methodology that is generally recognized and accepted in the water industry and by the Public Service Commission (the ‘PSC’) to determine the proposed wholesale rate.” Without question, reliance on the RD’s

calculation of minimum rates in the letter of conditions is generally recognized and accepted in the water industry. Since January 1, 2017, at least 23 cases have been presented to the Commission in which a utility sought an increase in water or sewer rates based on KRS 278.023 and the minimum rates identified in an RD Letter of Conditions.² Moreover, in the only other case filed by a municipality based on the RD's required minimum rates for approval of funding, the Commission approved the proposed rate identified in RD's Letter of Conditions, finding that its decision "complies with the policy of the General Assembly as expressed" in KRS 278.023. This methodology is undoubtedly generally recognized and accepted in the water industry.

Paragraph 14 of the contracts states that Central City "shall notify the Purchaser in writing of any proposed rate adjustment or modification to the wholesale rate within five (5) business days after the Central City Municipal Water and Sewer Board recommends a wholesale rate adjustment." There is no requirement that the Central City Municipal Water and Sewer Board recommend a wholesale rate. In this instance, no recommendation was made by the Board, nor was it necessary, because RD was requiring certain minimum rates for Central City to obtain favorable funding. Because the Board did not make a specific recommendation, nor was it required to make a recommendation, Central City did not have an obligation to inform the Districts of a recommendation.

Paragraph 14 of the contracts also states that Central City shall notify the Districts "at least 30 days before it is to be adopted as the actual wholesale rate. This will enable the Purchaser to review and comment on the proposed wholesale rate before it is actually adopted by the Seller." It also states, "At the expiration of the 30-day review period, the Seller may proceed to establish and adopt the new wholesale rate. The Seller shall immediately notify, in writing, the

² See Case Nos. 2019-00287, 2019-00275, 2019-00246, 2019-00180, 2019-00134, 2018-00371, 2018-00352, 2018-00203, 2018-00066, 2018-00048, 2017-00473, 2017-00455, 2017-00398, 2017-00392, 2017-00380, 2017-00339, 2017-00250, 2017-00245, 2017-00207, 2017-00200, 2017-00182, 2017-00144, and 2017-00138.

Purchaser of the new wholesale rate.” The intent of this 30-day window is clear from the language of the contract—it provides opportunity to the Districts to “review and comment on the proposed wholesale rate.”

The Districts had a 30-day period in which to review and comment on the proposed wholesale rate. Written notice was provided to the Districts on June 24, 2019. The proposed effective date was not until July 31, 2019. In other words, the Districts had 37 days to review and comment on the proposed wholesale rate.

Paragraph 15 states that “[t]he effective date of the new wholesale rate shall be at least 30 days after the Seller adopts the new rate. This will enable the Seller to file a revised tariff with the PSC and obtain PSC approval of the new rate.” The purpose of this provision is likewise clearly expressed in its terms. The 30-day window enables Central City to file the proposed rates with the Commission, as required by KRS 278.180. Central City provided the Commission with more time than the 30-day requirement mandates. The purpose of the provisions in paragraph 15 of the contracts is met because there was sufficient time for Central City to file the proposed rates with the Commission.

To the extent that the contract could be interpreted to require two consecutive 30-day periods (an initial 30-day period for the Districts to review and comment on the proposed rates and a second 30-day period for the City to provide statutory notice to the Commission), this 60-day window expires as of the date of the filing of this motion. The initial service of proposed rates on the Districts occurred on June 24, 2019, and 60 days thereafter is August 23, 2019. Accordingly, any Commission order approving Central City’s proposed rates will now be after any contemplated date in the contracts.

Paragraph 16 indicates that Central City and the Districts will establish a “Muhlenberg Joint City-County Water Production Planning Committee with one representative from each of the three public entities. Nothing in the contract, however, places any contingencies related to this Committee on Central City’s wholesale rate. In addition, although the Committee has not held a meeting for a period of time, the Districts hold a majority of seats (2 of 3) on the Committee and have not requested a meeting over that time.

As this discussion illuminates, Central City has substantially complied with the procedural provisions in the contract. And regardless of this substantial compliance, the Commission has authority to change the rates that are fixed by contract between a municipality and utility. In fact, KRS 278.200 specifically states that “the commission may . . . change . . . any rate or service standard of any utility that has been or may be fixed by any contract”

The Commission has acknowledged that this statute enables it to abrogate contracts between municipalities and utilities. In Utility Regulatory Commission Case No. 7794, Kenton County Water District applied for a rate increase, including an increase in wholesale rates set by contract with 5 cities.³ For example, the City of Ludlow had a contract executed in 1966 with a 20-year term setting the wholesale rate at 17.4 cents per 100 cubic feet of water.⁴ When the Commission approved the increase to 38 cents per 100 cubic feet of water, it effectively abrogated the contracts with the municipalities.⁵

Kentucky’s high court has likewise held that the Commission has the authority to change the rates set by contract regardless of the contractual provisions. In *Fern Lake Co. v. Public Service Commission*, the Commission argued that “the Commission’s prior approval of the contract does not estop it from subsequently changing rates therein when necessary in the public

³ See *Kenton Cnty. Water Dist.*, Case No. 8572 at 11 (Ky. PSC Mar. 22, 1983).

⁴ See OAG 81-44 (Feb. 6, 1981), available at 1981 WL 142327.

⁵ *Kenton Cnty. Water Dist.*, Case No. 8572 at 11.

interest.”⁶ The Court agreed, stating: “We cannot challenge the soundness of these contentions.”⁷ A number of other court decisions reiterate the ability of the Commission to change utility rates set by contract based on the police powers.⁸ In the present case, the public interest necessitates approval of the minimum wholesale rates set by RD so that Central City can receive loan and grant funding.

Regardless of the fact that Central City has substantially complied with the procedural provisions of the contract between it and the Districts, the Commission has authority to set the rates between those parties. In this particular case, Central City needs approval of the proposed rates in order to receive favorable funding from RD, including a \$150,000 grant. As described in this motion and attached Exhibit, this funding will be used for projects that are directly connected to the provision of water service to the Districts. If the Commission does not approve Central City’s proposed wholesale rate, the City’s ability to receive this funding shall be impaired and impeded.

By its enactment of KRS 278.023, the General Assembly has signaled its policy that the Commission should accept an agreement between water providers and federal agencies so as to not delay or jeopardize projects.⁹ Although that statute does not explicitly apply to cities, this Commission has previously explained that its approval of the minimum rate required by RD for a city to receive funding is supported by the policy of that statute.¹⁰ Any other result would impair or impede a city’s ability to receive funding.¹¹

⁶ *Fern Lake Co. v. Public Service Commission*, 357 S.W.2d 701, 704 (Ky. 1962)

⁷ *Id.*

⁸ *See, e.g., Peoples Gas Co. of Kentucky v. City of Barbourville*, 165 S.W.2d 567, 572 (Ky. 1942); *Southern Bell Tel. & Tel. Co. v. City of Louisville*, 96 S.W.2d 695, 697 (Ky. 1936)

⁹ *City of Harlan*, Case No. 2003-00358 at 2 n.1 (Ky. PSC Oct. 24, 2003).

¹⁰ *Id.* at 2.

¹¹ *Id.*

III. Conclusion

In a previous order, the Commission established this case because it determined that the record is not clear on whether Central City's proposed project is related to the provision of water service to the wholesale customers and whether Central City complied with certain procedural requirements set forth in contracts with the wholesale providers. This motion explains how Central City's proposed project is directly related to the provision of wholesale service to the Districts, how Central City has substantially complied with the procedural requirements of the contracts, and how the Commission has authority to change the wholesale rate regardless of those procedural provisions. Accordingly, Central City respectfully requests an order approving its proposed rate of \$3.31 per 1,000 gallons.¹²

Respectfully submitted,



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ATTORNEYS FOR CITY OF CENTRAL CITY

¹² If approved prior to substantial additional work that increases the City's rate case expenses, Central City will withdraw its request to recover rate case expenses through a monthly surcharge to the Districts.

CERTIFICATE OF COMPLIANCE

In accordance with 807 KAR 5:001, Section 8(7), this is to certify that the City of Pikeville's August 23, 2019, electronic filing is a true and accurate copy of the documents being filed in paper medium; that the electronic filing has been transmitted to the Commission on August 23, 2019; that there are currently no parties that the Commission has excused from participation by electronic means in this proceeding; and that an original and a copy of the filing are being delivered to the Commission within two (2) business days.

A handwritten signature in blue ink, appearing to read "M. Jon O'Brien", is written over a horizontal line.

Counsel for City of Central City

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