

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF MOUNTAIN)
WATER DISTRICT FOR A DECLARATORY ORDER) Case No. 2020-00394

**PIKEVILLE’S RESPONSE TO MOUNTAIN WATER DISTRICT’S
APPLICATION FOR DECLARATORY ORDER**

On December 15, 2020, MWD filed an application for declaratory order, in which it seeks a declaration from the Commission that the Commission’s decision in Case No. 2019-00080 eliminated the minimum-purchase provision in the contract between Pikeville and MWD. The orders in that case, however, did not eliminate the minimum-purchase provision. In addition, the Commission would not have jurisdiction to eliminate the minimum-purchase provision. Accordingly, MWD’s application must be rejected.

I. The Commission’s orders in Case No. 2019-00080 do not eliminate the minimum purchase provision of the parties’ contract.

Pikeville and MWD entered into a Wholesale Water Purchase Contract that was effective on and after January 1, 2012. In enumerated Paragraph 1 of that contract, MWD (as the Purchaser) agreed that “Purchaser agrees to buy . . . a minimum of 28 million gallons per month . . . at the rates provided for in paragraph 5.”¹ No actions have been taken to nullify the provisions of Paragraph 1 of the contract.

In 2019, Pikeville sought Commission approval for an increase in the wholesale rate for service to MWD. The Commission initiated an investigation into the reasonableness of that wholesale rate and docketed the case as Case No. 2019-00080. The Commission entered its

¹ This contract is attached as Exhibit 1.

initial determination on December 19, 2019, and subsequently entered an order on issues presented in a Petition for Rehearing on January 31, 2020.² The result of the case was to amend the rates identified in Paragraph 5. Neither of those orders mentions Paragraph 1's minimum-purchase provision. Simply put, the orders did not eliminate the minimum-purchase requirement from the contract.

As discussed below, the Commission does not have jurisdiction to eliminate the minimum-purchase requirement of the contract. But even if the Commission had jurisdiction to change such a contractual provision, it would have been required to follow the requirements of KRS 278.270. That statute requires a hearing related to the provision and a finding that the provision is “unjust, unreasonable, insufficient, unjustly discriminatory or otherwise in violation of any of the provisions of this chapter.” Pikeville did not propose to amend the minimum-purchase provision in Paragraph 1, and therefore, there was never a hearing on that provision. Moreover, none of the Commission's orders include a finding that the minimum-purchase requirement of the contract is unjust, unreasonable, insufficient, unjustly discriminatory, or otherwise in violation of a provision in KRS Chapter 278.

II. The Commission could not have amended the minimum-purchase provision of the contract because it did not have jurisdiction to do so.

The Commission has jurisdiction over rates and service of a municipality that provides utility services to a utility under a written contract. *See* KRS 278.200; *Simpson County Water Dist. v. City of Franklin*, 872 S.W.2d 460, 465 (Ky. 1994) At least one prior court decision determined that the Commission would not have jurisdiction to change a minimum-purchase provision in a contract because it is not a “rate”. *See Fern Lake Co. v. Public Service Comm'n*,

² These orders are attached as Exhibit 2 and 3.

357 S.W.2d 701, 704 (Ky. 1962). This Commission has described the holding of that case as follows:

In *Fern Lake*, the payment made annually by the utility under a contract for the purchase of facilities was not a “rate,” as defined under KRS 278.010(12), because the payment was not for service rendered or to be rendered by the utility to the seller of the facilities, and the payment did not vary with the quantity of service provided by the utility. In fact, the Court noted that the utility “has an absolute obligation to pay . . . \$17,700 annually whether or not it takes a drop of water”

Kentucky Frontier Gas, LLC, Case No. 2016-00287, 2016 WL 7336707, at *5 (Dec. 14, 2016).

The contractual provision at issue functions the same as the provision in *Fern Lake*. MWD has an obligation to pay Pikeville for 28,000,000 gallons of water per month. Regardless of whether MWD takes a drop of water, it is still obligated to pay for 28,000,000 gallons at the approved rate. This payment does not vary with the quantity of service provided by Pikeville. Accordingly, the minimum-purchase provision is not a “rate” on which the Commission has jurisdiction. *See Fern Lake*, 357 S.W.2d at 704. The Commission, therefore, could not have changed that provision in Case No. 2019-00080.

III. The Commission should decline to issue a decision on this application because it is effectively a breach-of-contract claim, over which the Commission would not have jurisdiction.

MWD’s application for declaratory order is essentially a breach-of-contract claim. MWD is questioning whether it would be liable for damages for failing to pay the minimum contractual amount based on 28,000,000 gallons.

The Commission does not have jurisdiction over breach-of-contract claims. Kentucky courts have held that, where the issue involved a unique and private contract between the provider and a particular customer, the courts and not the Commission has jurisdiction. *Bee's*

Old Reliable Shows, Inc. v. Kentucky Power Co., 334 S.W.2d 765, 766 (Ky. 1960). Likewise, the Court of Appeals has explained, “Nor would it be reasonable to infer that the Commission is so empowered or equipped to handle such claims consistent with constitutional requirement.” *Carr v. Cincinnati Bell, Inc.*, 651 S.W.2d 126, 128 (Ky. App. 1983) (citing Kentucky Constitution § 14). Although MWD has not requested monetary damages in this case, it is asking the Commission to render a decision on its obligation to pay Pikeville the contractual amount. Because this involves a unique and private contract between the provider and a particular customer, it should decline to render a decision on MWD’s application for declaratory order.

IV. Additional issues

In its Response to Pikeville’s motions, MWD suggests that the question presented in this case relates to the Commission’s “intent” or “intended interpretation” of the Commission’s orders in Case No. 2019-00080.³ The Commission, however, speaks through its orders. *See Union Light Heat & Power Co. v. Pub. Serv. Com’n*, 271 S.W.2d 361, 365 (Ky. 1954) (“the commission, like a court, acts and speaks only through its written orders”). In other words, if the Commission intended a certain result, it is required to state that in its written orders. *Id.* The Commission cannot now change its orders in Case No. 2019-00080 if it realizes that it intended a different result.

MWD’s arguments in its Response to Pikeville’s motions support the fact that the Commission cannot now change its orders in Case No. 2019-00080. MWD specifically argues that the underlying orders that are subject to an action for review in Franklin Circuit Court cannot be “re-litigated,” amended, or modified.⁴ The same argument applies to MWD’s attempt

³ See Response at 3 (filed Jan. 8, 2021).

⁴ See *id.* at 1, 3.

to have the Commission render an interpretation that was not included in the original orders. Those orders speak for themselves and cannot be changed now. *See In Re Pilgrim Telephone, Inc.*, 2000-00449, 2001 WL 1915754 (Aug. 28, 2001).

MWD also argues, “No additional facts are needed, no evidence can be introduced to affect that clarification” Ironically, it is MWD that is attempting to insert additional facts and evidence to change the Commission’s orders. Pikeville agrees that no additional facts or evidence are needed. Accordingly, MWD’s references to Pikeville’s underbilling in June through September (which Pikeville has subsequently rectified) and MWD’s Purchased Water Adjustment case have no bearing on the Commission’s decision in Case No. 2019-00080.

V. Conclusion

As discussed above, the Commission did not amend or change the minimum-purchase provision in Paragraph 1 of the Wholesale Water Purchase Contract. That provision is not even a “rate” that the Commission has authority to change. Rather, the Commission’s order changed the rates identified in Paragraph 5 of the contract. Accordingly, the Commission must reject MWD’s application for declaratory order seeking a ruling that is contrary to the terms of the Wholesale Water Purchase Contract.

Respectfully submitted,



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Attorneys for City of Pikeville

VERIFICATION

I, Philip Elswick, City Manager for the City of Pikeville, having first been duly sworn, hereby state that I have read the foregoing Response and that the facts contained therein are, to the best of my knowledge and belief, true and accurate.

BY: Philip Elswick
Philip Elswick

COMMONWEALTH OF KY)
)
COUNTY OF)

Subscribed and sworn to before me by Philip Elswick on this the 15th day of January, 2021.

Beverly Lynn Epling ID# KYN P17100
NOTARY PUBLIC, STATE AT LARGE, KY

COMMISSION EXPIRES October 19th 2024

CERTIFICATE OF COMPLIANCE

In accordance with 807 KAR 5:001, Section 8(7), this is to certify that the January 15, 2021, 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 January 15, 2021; 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 30 days after the lifting of the state of emergency.

M. Todd O'Connell
Counsel for City of Pikeville.

WHOLESALE WATER PURCHASE CONTRACT

THIS WHOLESALE WATER PURCHASE CONTRACT is entered into on the 14th day of November, 2011, and made effective on the 1st day of January, 2012, between the CITY OF PIKEVILLE, Kentucky, a municipality of the fourth class, of 118 College Street, Pikeville, Kentucky, hereinafter sometimes referred to as "SELLER" and MOUNTAIN WATER DISTRICT of P.O. Box 3157, Pikeville, Kentucky 41502, hereinafter sometimes referred to as "PURCHASER";

W-I-T-N-E-S-S-E-T-H:

WHEREAS, the Seller owns and operates a water production and supply distribution system with a capacity currently capable of serving the present customers of the Seller's system and desires to enter into a contract to provide water to the Purchaser to be distributed to the Purchaser's water supply distribution system.

WHEREAS, Purchaser is a Water District created under the provision of KRS Chapter 74 and owns and operates a water supply distribution system serving water users within the area described in plans now on file in the office of the Purchaser and to accomplish this purchase, the Purchaser desires to acquire a supply of potable treated water; and

WHEREAS, the parties hereto have heretofore entered into Water Purchase Contracts and amendments thereto dated January 12, 1987 and March 26, 1990, and May 29, 2009, and being subject to further amendments in regard to rates for water service, and by this Contract do supersede and replace said Contract and Agreements with the terms and conditions set forth herein.

KENTUCKY PUBLIC SERVICE COMMISSION
JEFF R. DEROUEN EXECUTIVE DIRECTOR
TARIFF BRANCH <i>Burt Kirtley</i>
EFFECTIVE 1/1/2012 <small>PURSUANT TO 807 KAR 5:011 SECTION 9 (1)</small>

WHEREAS, by resolution of the City of Pikeville, enacted on the 14th day of November, 2011, for the sale of water to the Purchaser in accordance with the provision of said resolution, and the execution of this Contract carrying out the said resolution by the Mayor of the City of Pikeville, and attested by the City Clerk, was duly authorized; and

WHEREAS, by resolution of Mountain Water District, enacted on the _____ day of _____, 2011, for the purchase of water from the Seller in accordance with the provisions of said resolution, and the execution of this contract by the Board Chairperson and attested by the Secretary, was duly authorized;

NOW, THEREFORE, in consideration of the foregoing and the mutual terms, conditions and agreements of the parties hereto that are hereinafter set forth, the parties do hereby agree as follows:

1. **WATER PURCHASES, QUALITY AND QUANTITY.** Seller agrees to produce and sell and Purchaser agrees to buy at "points of delivery" hereinafter specified in Paragraph 2 during the term of this Contract or any renewal or extension thereof, potable treated water meeting applicable quality standards of the Kentucky Natural Resources and Environmental Protection Cabinet, Division of Water, a minimum of 28 million gallons per month, not to exceed 40 million gallons per month, at the rates provided for in paragraph 5 herein. Seller does further agree to make up to 45 million gallons per month available to purchase so long as the additional 5 million gallons does not interfere with water service to the Sellers' then existing water customers.

2. **POINT OF DELIVERY AND PRESSURE.**

(A) The Water will be furnished by the Seller to the Purchaser at a reasonable constant pressure(s) and volume(s). If a greater *Bunt Kirtley* than that normally available at the points of delivery is required by the Purchaser,

KENTUCKY PUBLIC SERVICE COMMISSION
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TARIFF BRANCH
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the cost of providing such greater pressure shall be borne by the Purchaser. Emergency failure of pressure or supply due to main supply line breaks, power failure, flood, fire and use of water to fight fire, earthquake or other catastrophe shall excuse the Seller from this provision for such reasonable periods of time as may be necessary to restore service.

(B) The points of delivery shall be at the following points:

- a. Town Mountain Gap at U.S. 119.
- b. Chloe Creek Gap.
- c. York Town at Indian Hills.
- d. Island Creek Trailer Park.
- e. Cowpen.
- f. Hoopwood Hollow.
- g. Coon Branch.
- h. Cedar Gap.
- i. Left Fork Island Creek.

(C) It is understood and agreed by the parties hereto that in the event that the Purchaser should desire additional purchase points, and if additional pump stations, transmission lines and/or upgrade of existing lines is necessary to provide the additional purchase point(s) which are solely for the Purchaser's benefit, then the Purchaser shall pay the entire costs of the additional lines and equipment.

(D) That in the event both parties agree that a second Levisa Fork River crossing at or in the vicinity of the Island Creek Bridge becomes necessary to benefit both parties, it is understood that both parties shall equally share the costs and expense associated with said crossing

(E) That all extension of waterlines or up existing waterlines which shall thereafter become the obligation of the Purchaser to

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PUBLIC SERVICE COMMISSION

JEFF R. DEROUEN
EXECUTIVE DIRECTOR

TARIFF BRANCH

Brent Kirtley

EFFECTIVE

1/1/2012

PURSUANT TO 807 KAR 5:011 SECTION 9 (1)

maintain shall be done pursuant to the building specifications currently adopted by the Purchaser or hereafter adopted, and in conformance with regulations and construction standards mandated by the Kentucky Natural Resources and Environmental Protection Cabinet, regardless of which party may herein be required to pay or reimburse the cost thereof.

3. **METERING EQUIPMENT.** Seller shall furnish, install, operate, and maintain at its own expense at the points of delivery (subject however to the Purchaser's obligation to pay the costs for additional purchase points provide for in paragraph 2 (C) above) the necessary metering equipment, including a meter house or pit and required devices of standard type for properly measuring the quantity of water delivered to the purchaser and to calibrate such metering equipment whenever requested by the Purchaser but not more frequently than once every 12 months. A meter registering not more than 2 percent above or below the test results shall be deemed accurate. The previous reading of any meter disclosed by test to be inaccurate shall be corrected for the 12 months previous to such test and in accordance with the percentage of inaccuracy found by such tests. If a meter fails to register for any period, the amount of water furnished during such period shall be deemed to be the amount of water delivered in the corresponding period immediately prior to the failure, unless Seller and Purchaser shall agree upon a different amount. The metering equipment shall be read on the first day of the month by the Seller.

An appropriate official of the Purchaser at all reasonable times shall have access to the meter for the purpose of verifying its readings. Meters will be tested pursuant to applicable state regulations and copies of all testing reports will be provided to purchaser within 10 days of receipt of the

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4. **BILLING PROCEDURES.** The Seller shall furnish to the Purchaser at the above address not later than the fifth day of each month an itemized statement of the amount of water furnished the Purchaser during the preceding month. Payments shall be made within five (5) business days following the Board meeting for the month the bill is presented and approved.

5. **RATES.** Seller agrees to pay to Purchaser, not later than the 30th day of each month, for water delivered the preceding month in accordance with the following schedule of rates:

a. A wholesale rate of \$1.68 per one thousand (1,000) gallons of water for the first 28 million gallons per month.

b. \$1.30 per one thousand (1,000) gallons of water in excess of 28 million gallons per month.

6. **TERM OF CONTRACT.** This Contract shall extend for a term of 47 years from the date of the parties original agreement being January 12, 1987 and, thereafter may be renewed or extended for such term, or terms as may be agreed upon by the Seller and Purchaser. However, the rate schedule set forth in paragraph 5 above shall extend for a term of 5 years from the effective date of this agreement set forth hereinabove. The rate schedule shall automatically extend to additional year to year term(s) at the end of the original 5 year term or any one year extension term unless the "SELLER" sends a certified letter of its intent to change the rate to "Purchaser" six (6) months prior to the end of the original five (5) year term or any extension term. If the "Purchaser" is not agreeable to the proposed rate change, it shall within 60 days from receipt of the "Seller's" certified letter send a rejection notice by certified mail to the Seller and thereafter the Parties shall begin good faith negotiations to reach a rate schedule.

RECEIVED
PUBLIC SERVICE COMMISSION
DATE RECEIVED
EXECUTIVE DIRECTOR
TARIFF BRANCH
<i>Brent Kirtley</i>
EFFECTIVE
1/1/2012
PURSUANT TO 807 KAR 5:011 SECTION 9 (1)

If the Parties are unable to agree upon a new rate, then the Seller shall have prepared a cost of service study based on Public Service Commission requirements, and submit its rate application proposal to the Public Service Commission or such other agency which at said time has statutory jurisdiction.

7. **FAILURE TO DELIVER.** The Seller will, at all times, operate and maintain its system in an efficient manner and will take such action as may be necessary to furnish the Purchaser with quantities of water required by the Purchaser not to exceed the maximum amount provided for hereinabove. Temporary or partial failures to deliver water shall be remedied with all possible dispatch. In the event of an extended shortage of water, or the supply of water available to the Seller is otherwise diminished over an extended period of time, the supply of water to the Purchaser for Purchaser's customers shall be reduced or diminished in the same ratio or proportion as the supply to Seller's consumers is reduced or diminished. If Seller anticipates such an event, the Seller shall notify the Purchaser within 24 hours of any decision to reduce production.

8. **REGULATORY AGENCIES.** This Contract is subject to such rules, regulations or laws as may be applicable to similar agreements in this Commonwealth and the Seller and Purchaser will corroborate to obtain such permits, certifications or the like, as may be required to comply with said rules, regulations or laws as may now be applicable or as the same may be modified, amended or adopted hereinafter.

9. **SUCCESSORS TO PARTIES.** This agreement shall be binding on the party's representatives, successors and assigns.

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TARIFF BRANCH <i>Brent Kirtley</i>
EFFECTIVE 1/1/2012 PURSUANT TO 807 KAR 5:011 SECTION 9 (1)

10. **SELLER'S RIGHT OF RECIPROCITY OF WATER PURCHASES FROM PURCHASER.** Should circumstances arise wherein the City of Pikeville should need to purchase water from the Mountain Water District, Mountain Water District agrees to sell water which it produces to the City of Pikeville up to a maximum of 0.5 million gallons per day at the rate provided for in paragraph 5 herein at the delivery points provided for in paragraph 2 (B) hereinabove or as may be otherwise provided by the City of Pikeville herein at its sole costs. The City of Pikeville shall pay all monies due to Mountain Water District for water purchases within 30 calendar days of the date of billing. If a meter installation is needed to measure such purchase, the City of Pikeville shall pay for the same.

11. **COOPERATIVE AGREEMENT TO ASSIST IN THE COLLECTION OF DELINQUENT SANITARY SEWER SERVICE CHARGES.** The Parties hereto agree that each of the Parties do or may in the future from time to time provide sanitary sewer services to the other Parties water customers and each shall assist the other Party to collect delinquent sanitary sewer service charges by disconnecting water services to its customers who are delinquent in the payment of the sanitary sewer fees to the other party herein. The parties hereto agree to jointly execute a cooperative agreement to provide for reciprocal disconnect of water services to delinquent sanitary sewer customers in the same form as attached hereto and marked as Exhibit A for identity.

12. **PUBLIC SERVICE COMMISSION APPROVAL.** The parties hereto agree and understand that this Agreement must be approved by the Public Service Commission and in the event that said approval is not received by the effective date provided for herein then the effective date shall be considered the date that the Public Service Commission approves this Purchase Contract.

KENTUCKY
PUBLIC SERVICE COMMISSION
JEFF R. DEROUEN
EXECUTIVE DIRECTOR
TARIFF BRANCH
Brent Kirtley
EFFECTIVE
1/1/2012
PURSUANT TO 807 KAR 5:011 SECTION 9 (1)

IN WITNESS WHEREOF, the parties hereto acting under authority of their respective governing bodies, have caused this Contract to be duly executed in two counterparts, each of which shall constitute an original the day and year first above written.

Attested:

Christy Billiter
CHRISTY BILLITER, City Clerk

Attested:

Ancie Casey
Secretary

SELLER:

CITY OF PIKEVILLE

By: Frank Justice
FRANK JUSTICE

Its: Mayor

PURCHASER:

MOUNTAIN WATER DISTRICT

By: Rhonda James
RHONDA JAMES

Its: Chairperson

**PUBLIC SERVICE COMMISSIONER
APPROVAL:**

By: _____

Its: _____

Date: _____

KENTUCKY PUBLIC SERVICE COMMISSION
JEFF R. DEROUEN EXECUTIVE DIRECTOR
TARIFF BRANCH <u>Brent Kirtley</u>
EFFECTIVE 1/1/2012
PURSUANT TO 807 KAR 5:011 SECTION 9 (1)

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC PROPOSED ADJUSTMENT OF)	
THE WHOLESALE WATER SERVICE RATES)	CASE NO.
OF THE CITY OF PIKEVILLE TO MOUNTAIN)	2019-00080
WATER DISTRICT)	

ORDER

By tariff filing submitted on February 21, 2019, the city of Pikeville (Pikeville) proposes to increase the wholesale water rates it charges to Mountain Water District (Mountain District). Pikeville currently charges Mountain District \$1.68 per 1,000 gallons for the first 28,000,000 gallons purchased and \$1.30 per 1,000 gallons for purchases above 28,000,000 gallons.¹ Pikeville proposes to increase its volumetric rate for all water purchased by Mountain District to \$2.30 per 1,000 gallons. Pikeville further proposes to assess a monthly surcharge to Mountain District over 36 months to recover any rate case expenses it incurs participating in and defending its proposed rates in this current proceeding.² The proposed tariff listed the Rate Case Expense Surcharge as \$2,500 per month. The table below is a comparison of Pikeville’s current and proposed volumetric wholesale rates for Mountain District.

			<u>Existing Rates</u>	<u>Proposed Rates</u>	<u>Increase</u>
First	28,000,000	Gallons	\$ 1.68 per 1,000 Gallons	\$ 2.30 per 1,000 Gallons	36.9%
Next	28,000,000	Gallons	\$ 1.30 per 1,000 Gallons	\$ 2.30 per 1,000 Gallons	76.9%

¹ Pikeville’s responses to June 10, 2019 Order, Item 1, Direct Testimony of Philip Elswick (Elswick Testimony), page 3.

² TFS 2019-00080, *Electronic Proposed Adjustment of the Wholesale Water Service Rates of the City of Pikeville to Mountain Water District* (filed Feb.21, 2019).

The Commission has jurisdiction over Pikeville's rates for wholesale water service to Mountain District pursuant to KRS 278.200 and the Supreme Court's decision in *Simpson County Water District v. City of Franklin*, 872 S.W.2d 460, 463 (Ky. 1994), in which the Court 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."³ Following the Court's decision in *Simpson County*, the Commission has allowed city-owned utilities to file rate adjustments by a tariff filing, and if a hearing is requested and 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.⁴ The parties in this case present two issues to the Commission. The first issue is whether Pikeville's proposed rate increase is fair, just, and reasonable based upon the evidentiary record and the second issue is whether Pikeville's rate case expense and the proposed 36-month surcharge to recover that expense is fair, just, and reasonable based upon the evidentiary record.

³ *Simpson County Water District v. City of Franklin*, 872 S.W.2d 460, 463 (Ky. 1994).

⁴ *Id.*; *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, 1016).

BACKGROUND

Pikeville is a city of the third class⁵ that owns water treatment and distribution facilities that are operated as a department of the city, pursuant to KRS 96.320.⁶ Pikeville provides retail water service to 4,972 customers⁷ located in and near Pikeville, Kentucky. In addition to its retail water service, Pikeville provides wholesale water service to Mountain District and Southern Water and Sewer District (Southern District).⁸ The wholesale water rate that Pikeville charges to Mountain District was last adjusted in 2009.⁹

Mountain District is a water district organized pursuant to KRS Chapter 74 that owns and operates a water distribution system through which it provides water service to approximately 16,611 retail customers in Pike County, Kentucky.¹⁰ Mountain District's last general rate adjustment occurred in 2015.¹¹

⁵ KRS 81.010(3).

⁶ Pikeville's responses to the Commission's June 10, 2019 Order, Item 1, Direct Testimony of Philip Elswick (Elswick Testimony) page 2, Lines 6-7.

⁷ Pikeville's Responses to Commission Staff's Third Request for Information (Staff's Third Request), Item 14. 3,318 (Inside City Customers) + 1,654 (Outside City Customers) = 4,972 (Total Customers).

⁸ Pikeville's responses to the Commission's June 10, 2019 Order, Item 1, Elswick Testimony page 2, Lines 7-8.

⁹ *Id.* Lines 15-16.

¹⁰ *Annual Report of Mountain County Water District to the Public Service Commission for the Calendar Year Ended December 31, 2018* at 12 and 49.

¹¹ Case No. 2014-00342, *Application of Mountain Water District for an Adjustment of Water and Sewer Rates* (Ky. PSC Oct. 9, 2015).

PROCEDURAL

On February 21, 2019, pursuant to 807 KAR 5:011, Pikeville filed a revised tariff proposing to increase its existing rate for wholesale water service to Mountain District.¹² On March 4, 2019, Mountain District, through counsel, submitted a letter requesting that the Commission open a formal proceeding to investigate the reasonableness of the proposed rate, establish a procedural schedule, and ensure that the proposed rate is not placed into effect before the Commission conducts a hearing.¹³ By Order dated March 28, 2019, 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 September 4, 2019. The Commission further granted Mountain District leave to intervene in this current proceeding.

On July 23, 2019, the Commission, on its own motion, scheduled an evidentiary hearing in this proceeding, to be held on August 22, 2019. In its July 24, 2019 Motion, Mountain District requested that the hearing be rescheduled due to a scheduling conflict on the part of one of its attorneys; the hearing was then rescheduled for September 11, 2019.

On September 3, 2019, Pikeville, pursuant to KRS 278.190(2) provided notice to the Commission of its intent to implement the proposed volumetric rate to Mountain District for water sold on or after September 5, 2019. The notice also stated that Pikeville would not implement the proposed rate case expense surcharge until the Commission's

¹² KRS 278.190(3) requires that the Commission render a final decision on Pikeville's proposed rate no later than ten months after the filing of the schedule. This ten-month period ends on December 20, 2019.

¹³ Protest Letter from Mountain District (filed March 4, 2019).

final order is issued. The Commission ordered Pikeville, pursuant to KRS 278.190(2), to maintain its records in a manner that would enable Pikeville, or any of its customers, or the Commission, to determine the amounts to be refunded and to whom due in the event a refund is ordered.

Following extensive discovery, the Commission held an evidentiary hearing on September 11, 2019, in Frankfort, Kentucky. Testimony was presented on behalf of Pikeville by Philip Elswick, Samuel Petty, Tonya Taylor, and Grondall Potter. Connie Allen, P.E., provided testimony on behalf of Mountain District. Both Pikeville and Mountain District submitted written briefs. This matter now stands submitted to the Commission for a decision.

TEST PERIOD

Pikeville proposes, and the Commission finds reasonable, the use of the 12-month period ending June 30, 2017 (Fiscal Year 2017) as the test period for determining the reasonableness of the proposed rate. The Commission's adjustments to Pikeville's test-year revenues and expenses are discussed below.

REVENUES AND EXPENSES

During Fiscal Year 2017, Pikeville reported operating revenues and operating expenses of \$2,452,736 and \$2,429,546, respectively.¹⁴ The Commission's review of Pikeville's test-year operating revenues and expenses are set forth below.¹⁵

¹⁴ Pikeville's responses to the Commission's June 10, 2019 Order, Item 10. Pikeville filed the excel spreadsheet for the Fiscal Year 2017 Trial Balance on September 10, 2019.

¹⁵ See Appendix A for the Pro Forma Income Statement.

UMG Reimbursements

In its audited trial balance for Fiscal Year 2017 general ledger, Pikeville reported gasoline and telephone expenses of \$144,174 and \$8,206, respectively.¹⁶ Pikeville also reported water special revenue of \$150,303,¹⁷ which represents reimbursements Pikeville received from UMG for the water department's fuel and phone use.¹⁸ Pikeville explains that:

The City is able to purchase fuel at a lower cost and bill to UMG, which puts [sic] burden back on UMG to operate in an efficient manner. The phone system is tied together with public works due to customer service, and UMG reimburses for phones allocated to them.¹⁹

The gasoline and telephone/public works expenses are being recovered by UMG through its annual management fee.²⁰ To simplify the revenue requirement calculation and to eliminate any possibility of double recovery of these expenses, the Commission is reducing operating revenues and expenses by \$150,303.²¹

Cost Allocations

In fiscal year 2006, when Pikeville acquired the assets formerly owned by the Sandy Valley Water District (Sandy Valley District) it separated its water department into

¹⁶ Pikeville's responses to the Commission's June 10, 2019 Order, Item 10.

¹⁷ *Id.*

¹⁸ Pikeville's responses to Staff's Second Request, Item 18.

¹⁹ Pikeville's responses to Commission Staff's Post Hearing Request (Staff's Post-Hearing Request), Item 1.

²⁰ *Id.*, Item 2.

²¹ Operating Expenses: \$(144,174) (Gasoline) + \$(6,129) (Telephone) = \$(150,303). The telephone expense was not adjusted down by the entire fiscal year amount of \$8,206 as the net difference between the revenue and expense adjustment should be zero.

service areas inside and outside the city limits and began to maintain separate general ledgers for each customer class.²² Pikeville's goal was to track expenses and revenues separately between the two customer classes in order to set separate rates.²³ Pikeville allocates the identified shared costs (variable and fixed) between the two customer classes based upon water consumption.²⁴ In Fiscal Year 2017, Pikeville allocated 77.13 percent of the shared cost to customers inside the city limits and 22.87 percent to the customers outside the city.²⁵ Pikeville designates its wholesale water customers as inside city customers.

This allocation was explained by Tonya Taylor, who testified that Pikeville allocates costs of its treatment plant (electricity, repairs, and UMG management fee) between its two customer classes using a customer consumption factor.²⁶ Ms. Taylor added that, in her opinion, allocating costs using the consumption factor should not result in volatile or unstable cost allocations between fiscal years and is the most practical allocation factor for Pikeville to use.²⁷ Ms. Taylor explained that Pikeville has not performed an analysis or study to support its use of consumption to allocate the shared costs between the inside city and outside city systems.²⁸

²² Pikeville's responses to Staff's Third Request, Item 10.

²³ *Id.*

²⁴ Pikeville's responses to the Commission's June 10, 2019 Order, Item 8.

²⁵ *Id.*

²⁶ September 11, 2019 Hearing Video Transcript (HVT) at 18.10.

²⁷ September 11, 2019 HVT at 18.55.

²⁸ September 11, 2019 HVT at 17.33.

Given the absence of a supporting study or analysis, the Commission finds that Pikeville’s fixed shared costs would not vary with the amount of water that Pikeville either produces or sells. In prior proceedings the Commission has found that a more equitable allocation method to use is a factor based on the number of customers that are served by each division (Customer Allocation Factor).²⁹ The Commission finds that Pikeville’s shared fixed costs should be reallocated using a five-year average Customer Allocation Factor.³⁰ The customer allocation factor for the outside-the-city system is 33.423 percent and the factor for the inside-the-city system is 66.577 percent, as calculated in the table below:

Fiscal Years	Customers				Total
	Outside	%	Inside	%	
2018	1,541	32.836%	3,152	67.164%	4,693
2017	1,653	33.253%	3,318	66.747%	4,971
2016	1,639	33.517%	3,251	66.483%	4,890
2015	1,696	33.718%	3,334	66.282%	5,030
2014	1,727	33.790%	3,384	66.210%	5,111
	<u>8,256</u>	<u>33.432%</u>	<u>16,439</u>	<u>66.568%</u>	<u>24,695</u>
		<u>33.423%</u>		<u>66.577%</u>	

Reallocating the shared fixed costs between the two customer classes results in a decrease of \$106,059 in operation and maintenance expense allocated to inside-the-

²⁹ See, e.g. Case No. 2012-00309, *Application of Southern Water and Sewer District for an Adjustment in Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC: Staff Report issued Feb. 15, 2013; Final Order issued July 12, 2013); Case No. 2013-00350, *Alternative Rate Adjustment Filing Garrison-Quincy-Ky-O-Heights Water District* (Ky. PSC: Staff Report issued Jan. 17, 2014; Final Order issued Feb 19, 2014); Case No. 2017-00074, *Application of Western Lewis Rectorville Water and Gas District for Rate Adjustment for Small Utilities Pursuant to 807 KAR 5:076* (Ky. PSC: Staff Report issued July 17, 2017; Final Order issued Oct. 18, 2017); Case No. 2017-00371, *Application of Symsonia Water and Sewer District for Rate Adjustment Pursuant to 807 KAR 5:076* (Ky. PSC: Staff Report issued Jan. 3, 2018; Final Order issued Mar. 30, 2018); and Case No. 2018-00117, *Application of Ledbetter Water District for an Alternative Rate Adjustment* (Ky. PSC: Staff Report issued July 16, 2018; Final Order issued Sep. 10, 2018).

³⁰ Pikeville’s responses to Staff’s Post-Hearing Request, Item 12.

city customers. A listing of the adjustments to reallocate each shared fixed cost is contained in the following table.

Account Title	Allocation Adjustment
Insurance	(11,663) ³¹
Public Works Water - UMG Mgt Fee	(49,416) ³²
UMG...Services	(39,598) ³³
Repairs/Maintenance	(3,254) ³⁴
Repairs and Maintenance Plant	(2,128) ³⁵

The only variable shared cost reported by Pikeville as a separate line item is electric expense.³⁶ Given that Pikeville would be unable to provide water service to the outside-the-city system without the pumping stations and the storage tanks located inside the city system, the Commission is allocating total test-year electric expense between the two customer classes using a five-year average of water produced and sold. Inside-the-city electric expense is being decreased by \$46,328, as calculated in the table following.

³¹ \$29,134 (Reported Inside City) + \$5,762 (Allocated Outside City) = \$34,896 x (33.423%) (Customer Allocation Factor –Outside City) = \$(11,663).

³² \$1,671,184 (UMG Mgt Fee Water Department) x 66.577% (Customer Allocation Factor – Inside City) = \$1,112,624 (Reallocated UMG Fee Inside City) - \$1,162,040 (Reported UMG Fee Inside City) = \$(49,416).

³³ \$141,565 (Reported UMG Services) - \$23,091 (Capital & Retail Cust. Costs) = \$118,474 x (33.423%) (Customer Allocation Factor –Outside City) = \$(39,598).

³⁴ \$139,077 (Reported Repairs/Maintenance) - \$129,342 (Nonrecurring & Capital Costs) = \$9,735 x (33.423%) (Customer Allocation Factor –Outside City) = \$(3,254).

³⁵ \$30,632 (Reported Repairs & Maintenance Plant) - \$24,264 (Nonrecurring Costs) = \$6,368 x (33.423%) (Customer Allocation Factor –Outside City) = \$(2,128).

³⁶ Chemical expense is also a variable cost, but it is embedded in the UMG Management Fee so an additional adjustment is unnecessary.

Reported Electric Inside City	\$ 299,596
Add: Electric Expense Allocated Outside City: Treatment Plant	<u>43,440</u>
Total Electric Expense	343,036
Divided by: Average Water Production	<u>1,221,449,560</u>
Electric Cost per Gallon	0.000281
Multiplied by: Average Inside Water Sales	<u>901,310,007</u>
Reallocated Inside City Electric Expense	253,268
Less: Reported Electric Expense	<u>(299,596)</u>
Pro Forma Adjustment	<u>\$ (46,328)</u>

Customer-Related Costs

In its rate study, Pikeville allocated its functional costs between the categories of administration, water treatment plant, and distribution.³⁷ Pikeville next divided the costs in each of the three categories into either fixed or variable costs.³⁸ The costs identified by Pikeville as fixed were not allocated or recovered in its proposed wholesale rate.³⁹

According to the American Water Works Association (AWWA) Manual of Water Practices, Principals of Water Rates, Fees, and Charges (AWWA M1 Manual):

Wholesale rates should be designed to recover costs of providing service based on usage, pattern of usage, and level of service of individual wholesale class members. Often in developing a rate design to recover the cost of providing wholesale service, customer-related costs are a small percentage of the total cost of service. Rather than use a wholesale service charge, some utilities recover customer related costs through the commodity, or volume charge.⁴⁰

³⁷ Pikeville's responses to the Commission's June 10, 2019 Order, Item 1, Elswick Testimony page 3, Lines 16-17.

³⁸ *Id.*, Lines 17-18.

³⁹ *Id.*, Line 21.

⁴⁰ AWWA M1 Manual, page 236.

Following the directions of the AWWA M1 Manual, the Commission has identified the customer-related costs that should be allocated to the wholesale customers and is allocating 0.181 percent of those costs to the wholesale customers.⁴¹ The remaining customer-related costs should be totally recovered from the retail water customers. The Commission is allocating 0.181 percent of the customer-related costs as detailed in the table below, which is a list of the fixed (administrative) costs identified by Pikeville as being allocated to the wholesale rate and to the retail rates.

	Test-Year Amounts	Wholesale Allocations		Administrative Costs - Retail
		Factors	Amounts	
Other Water Revenues:				
Bad Debt Recovery	\$ (290)	0.000%	\$ -	\$ (290)
Water Tap Fee	(24,510)	0.000%	0	(24,510)
Water Penalty	(10,911)	0.000%	0	(10,911)
Operating Revenue	(35,711)		0	(35,711)
Operating Expenses:			0	
Bank Charges-Water Revenue	(3,890)	0.181%	7	(3,883)
Provision For Bad Debt	(1,158)	0.000%	0	(1,158)
Dues	(850)	0.181%	2	(848)
Freight/Postage	(1,349)	0.181%	2	(1,347)
Office Supplies	(2,489)	0.181%	5	(2,484)
Public Works Water - UMG MGT Fee	(58,102)	0.181%	105	(57,997)
Prof Service Other	(777)	0.181%	1	(776)
Ut Monthly Billing/Professional Services	(3,803)	0.181%	7	(3,796)
Rent-Easements	(376)	0.181%	1	(375)
Purchase Software	(1,845)	0.181%	3	(1,842)
Workers Comp	(286)	0.000%	0	(286)
Salaries & Wages	(21,294)	0.000%	0	(21,294)
Employee Benefit Insuranc	(7,567)	0.000%	0	(7,567)
Pension Matching	(8,719)	0.000%	0	(8,719)
Taxes Other Than IncomeTax:				
Payroll Tax	(1,629)	0.000%	0	(1,629)
Unemployment Tax	(127)	0.000%	0	(127)
Operating Expense	(114,261)		133	(114,128)
Net Operating Income	\$ 78,550		\$ (133)	\$ 78,417

⁴¹ $4,971$ (Pikeville Retail Customers Fiscal Year 2017) \div 9 (Wholesale Master Meters) = $4,980$ (Monthly Bills). 9 (Wholesale Master Meters) \div $4,980$ (Total Retail and Master Meters) = 0.181% .

UMG Management Fees

On July 1, 2007, Pikeville and UMG entered into an Agreement for Operations, Maintenance and Management Services (Management Agreement), wherein UMG agreed to manage and operate the following city departments: Streets; Parks; Landscape; Gas; Water; Garbage; and Wastewater.⁴² UMG's compensation under the Management Agreement for the first year, fiscal year ending June 30, 2008, was listed as \$4,026,174, with a maintenance and repair limit of \$494,904 for the water department.⁴³ However, in the first amendment to the Management Agreement, dated July 23, 2007, UMG's management fee for fiscal year 2007 was increased to \$4,399,474 and the maintenance and repair limit for the water department increased to \$546,904.⁴⁴ The reason given for the increases in the fiscal year 2007 UMG fees was Pikeville's acquisition of the Sandy Valley District's system located in Pike County and the acquisition of Mountain District's Mossy Bottom sewer system.⁴⁵

UMG and Pikeville agreed in the Fifth Amendment to the Management Agreement, dated February 14, 2010, that effective July 1, 2010, Pikeville would be directly responsible for paying all costs associated with maintenance and repairs, thereby reducing the annual UMG fee by the maintenance and repair limit.⁴⁶ This modification

⁴² Pikeville's responses to Commission Staff's Second Request for Information (Staff's Second Request), Items 20.a, Management Agreement and 20.b, Management Agreement Costs by Major Functions.

⁴³ *Id.*, Item 20.a, Management Agreement, page 11, paragraph 8.1.

⁴⁴ *Id.*, Amendment One to the Management Agreement.

⁴⁵ *Id.*

⁴⁶ *Id.*, Amendment Five to the Management Agreement.

reflected Pikeville's and UMG's intent to keep system maintenance and repair costs as low as possible by eliminating the 6 percent state sales tax paid on materials and supplies purchased by UMG to make the maintenance and repairs.⁴⁷

The total Management Fee Pikeville paid to UMG in Fiscal Year 2017 was \$4,341,794, of which \$1,671,185 was allocated to the water department.⁴⁸ In Fiscal Year 2017, Pikeville allocated \$1,162,040 of the annual UMG management fee and \$141,565 of the UMG repairs and maintenance costs to inside-the-city accounts.⁴⁹

According to Pikeville, there was a joint effort between UMG and Pikeville administrators to develop the departmental allocations when the UMG contractual management relationship was initiated.⁵⁰ Pikeville claims that the initial allocation to inside-city water has only been increased by the overall percentage increase and that the expense allocations to the inside-city water system has not increased for unrelated changes in the scope of UMG's work (i.e.; additional employees to clean litter along roads and city streets).⁵¹

Pikeville provided the following four explanations as to why the allocation of the UMG management fee to the inside-the-city water system is reasonable.

1. The Management Agreement between Pikeville and UMG is the result of an arms-length transaction between two independent parties. In prior decisions the

⁴⁷ *Id.*

⁴⁸ Pikeville's responses to Staff's Post-Hearing Request, Item 5.

⁴⁹ Post-Hearing Brief of Pikeville (Pikeville's Brief) page 6.

⁵⁰ Pikeville's Brief, Pages 6-7.

⁵¹ *Id.*, Page 7.

Commission has held that contracts negotiated at arms-length deserve a presumption of reasonableness. In Case No. 2002-00022,⁵² the Commission found that Pikeville's decision to contract for the operation and maintenance of its water system is a management decision that is presumed to be reasonable. The Commission further found that, "[t]he burden of overcoming the presumption of managerial good faith falls on the party challenging it."⁵³

2. UMG's calculation of the expenses it incurred in Fiscal Year 2017 to operate Pikeville's water department are remarkably close to the Management Fee that was allocated to Pikeville's water department. UMG's breakdown of expenses related to providing operational and management services to Pikeville's water department totaled \$1,670,884, while the management fee allocated to the water department was \$1,671,185. The difference between the expenses UMG actually incurred and the management fee allocation is \$301.⁵⁴

3. A comparison of Pikeville's water department expenses with the expenses identified in annual reports of twenty utilities regulated by the Commission demonstrates that Pikeville's expenses related to the services provided by UMG are reasonable. A comparison based on consumption reveals that only one out of the twenty regulated water utilities has a lower cost per thousand gallons.⁵⁵

⁵² Case No. 2002-00022, *Proposed Adjustment of Wholesale Water Service Rates of the City of Pikeville, Kentucky* (Ky. PSC Oct. 18, 2002).

⁵³ Pikeville's Brief, Page 7, *quoting*, Case No. 2002-00022, *Proposed Adjustment of Wholesale Water Service Rates of the City of Pikeville, Kentucky* (Ky. PSC Oct. 18, 2002) at 8

⁵⁴ *Id.* Pages 7-8.

⁵⁵ *Id.* Page 8.

4. Pikeville performed an expense per customer comparison using four other utilities that produce nearly all of their own water and have more than 40 percent of water consumption to wholesale customers. Pikeville's comparison revealed that Pikeville's UMG expenses fell within the middle of the comparative utilities' expenses and that Pikeville's expense for each of the three factors used was below the median cost per customer of each of the four utilities.⁵⁶

Pikeville concluded that there is no valid reason for the Commission to deviate from its long-standing policy that arms-length transactions are presumed to be reasonable.⁵⁷ In the absence of a presumption of reasonableness, Pikeville argues that it has provided quantifiable data to show that the expense allocation of the UMG management fee to the water department is reasonable.⁵⁸

Mountain District argues that Pikeville has not presented any evidence to show that its UMG contract was either bid or cost-effective.⁵⁹ Mountain District notes that Pikeville was unable to produce any memoranda, correspondence, or other documents showing that Pikeville had analyzed, reviewed, or discussed its contract negotiations with UMG.⁶⁰ This failure, according to Mountain District, places the burden upon the Commission and Mountain District to show that the presumptively reasonable UMG management fees are unreasonable - a difficult if not impossible proposition.⁶¹

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ Post-Hearing Brief of Mountain District (Mountain District's Brief) page 21.

⁶⁰ *Id.*

⁶¹ *Id.* at 22.

Mountain District explains that in Pikeville's comparative analysis, it simply listed the revenues and expenses of several regulated water systems, without providing evidence showing the correlation or the relevance to the UMG expenses allocated to Pikeville's water division.⁶² Mountain District notes that even the information that has been provided for the UMG operational expenses is unaudited.⁶³ According to Mountain District, the evidence shows that UMG simply bills Pikeville and that Pikeville unquestionably accepts any increase to the UMG annual management fee that is due to either increases in the Consumer Price Index or operational changes.⁶⁴ Mountain District stated that Pikeville did not present any evidence supporting the methodology that is used to allocate the UMG management fee to each of Pikeville's city departments.⁶⁵ According to Mountain District, Pikeville's defense is that it requested evidence to support the allocations from UMG, but UMG had not provided the requested information to Pikeville.⁶⁶

Mountain District contends that the UMG management fee cannot be verified at any level and that verification becomes moot and the Commission's oversight is relegated to a determination of the reasonableness of the total level of operating expense, but not the level of any specific expense category.⁶⁷ While this arrangement would simplify the

⁶² *Id.* at 23.

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ *Id.*

⁶⁶ *Id.*

⁶⁷ *Id.* at 24.

utility's filing requirements, Mountain District claims that it would stifle the Commission's traditional review of known and measurable revenues and expenses.⁶⁸

In Pikeville's last fully-litigated rate case⁶⁹ before the Commission, Mountain District raised the same objections to Pikeville's management contract with Professional Services Group (PSG) as it has raised in this current proceeding with the UMG Management Agreement.⁷⁰ In that proceeding the Commission rejected Mountain District's objections finding that:

Hindsight cannot be used in evaluating the prudence of management's actions. Management must be judged on what was known or should have been known at the time of its decision. The burden of overcoming the presumption of managerial good faith falls on the party challenging it. Once this burden is met, however, management must demonstrate that its actions were reasonable and prudent.⁷¹

The Commission also found no merit to Mountain District's contention that the lack of individual cost components for each management service provided to Pikeville from PSG rendered the lump sum management fee unreasonable or unfit for rate recovery. In

⁶⁸ *Id.*

⁶⁹ Case No. 2002-00022, *Proposed Adjustment of Wholesale Water Service Rates of the City of Pikeville, Kentucky* (Ky. PSC Oct. 18, 2002).

⁷⁰ *Id.* at 8-9. First, Mountain District contends that Pikeville has failed to demonstrate that its decision to enter a management services contract with PSG or that the provisions of that contract with PSG are reasonable. Second, Mountain District contends that Pikeville has not identified the individual components of the contract or presented any evidentiary support of the actual costs of the services that PSG provides. Finally, Mountain District contends that, by contracting for the management services, Pikeville seeks to circumvent the regulatory review of its operations by presenting the Commission with a *fait accompli*.

⁷¹ Case No. 2002-00022, *Proposed Adjustment of Wholesale Water Service Rates of the City of Pikeville, Kentucky* (Ky. PSC Oct. 18, 2002) at 9. (Internal citations omitted.)

its decision the Commission noted that Pikeville's payments are the result of an arms-length transaction and that they were documented by separate invoices.

Pikeville's contractual arrangement with UMG, in which the annual management fee is not broken down into its separate cost components is not uncommon. In Case No. 2017-00338, the Commission found that the annual management fee U. S. 60 Water District of Shelby and Franklin Counties paid to North Shelby Water Company was reasonable.⁷² In Case No. 2018-00429 the Commission found reasonable the \$890,730 annual management fee Graves County Water District paid to Mayfield Electric and Water Systems pursuant to an operational agreement.⁷³ In both cases the managing company did not provide the Commission or its Staff a breakdown of the contract fee into its individual cost components.

The Commission finds little merit in the arguments presented by Mountain District, and accordingly, finds that the present management services agreement between UMG and Pikeville to be reasonable.

In fiscal year ending June 30, 1997, Pikeville paid to PSG an annual fee of \$1,242,026 for the management of its water department. The management fee that Pikeville paid to UMG in the test year is \$1,671,185. In the 20 years since Case No. 2002-00022, Pikeville's management fee has increased by \$429,159, for an average

⁷² Case No. 2017-00388, *Electronic Application of U.S. 60 Water District of Shelby and Franklin Counties for an Alternative Rate Adjustment* (Ky. PSC Staff Report issued Feb. 8, 2018; Final Order issued Mar. 21, 2018) Staff's finding page 7 of its report; The Commission ordered that: The findings contained in the Staff Report are adopted and incorporated by reference into this Order as if fully set out herein.

⁷³ Case No. 2018-00429, *Application of Graves County Water District for an Alternative Rate Adjustment* (Ky. PSC Staff Report issued June 10, 2019; Final Order issued Aug. 30, 2019) Staff's finding page 10 of its report; The Commission ordered that: The findings contained in the Staff Report are adopted and incorporated by reference into this Order as if fully set out herein.

annual increase of \$21,458, or 1.73 percent per year. For comparison the average Consumer Price Index (CPI) for the same period of 1997 through 2017 is 2.15 percent,⁷⁴ as calculated below. Based on the CPI comparison, the Commission has determined that the total allocation of UMG management fee to the water department is reasonable.

Year	CPI
1997	2.30%
1998	1.60%
1999	2.20%
2000	3.40%
2001	2.80%
2002	1.60%
2003	2.30%
2004	2.70%
2005	3.40%
2006	3.20%
2007	2.80%
2008	3.80%
2009	-0.40%
2010	1.60%
2011	3.20%
2012	2.10%
2013	1.50%
2014	1.60%
2015	0.10%
2016	1.30%
2017	2.10%
Average CPI	2.15%

UMG Services

In its Fiscal Year 2017 Trial Balance, Pikeville reported a UMG service expense of \$141, 565, which represents reimbursements Pikeville made to UMG for maintenance supplies.⁷⁵ Upon its review of the general ledger, the Commission notes that Pikeville recorded as an expense \$23,091 of capital expenditures that would be used solely to

⁷⁴ <https://www.statista.com/statistics/191077/inflation-rate-in-the-usa-since-1990>.

⁷⁵ Pikeville's responses to the Commission's June 10, 2019 Order, Item 10.

provide service to its retail customers. Accordingly, UMG service expense is being reduced by \$23,091 to eliminate the capital expenditures that should not be recovered from the wholesale water customers with no corresponding adjustment to depreciation.

Repairs and Maintenance

In its Fiscal Year 2017 Trial Balance, Pikeville reported a repair and maintenance plant expense of \$139,077.⁷⁶ For ratemaking purposes, costs classified as nonrecurring are removed from a utility's operating expenses and are amortized over their estimated useful life. We find that repairs and maintenance expense should be decreased by \$99,506⁷⁷ to eliminate for ratemaking purposes the costs that the Commission classifies as nonrecurring. Operating expenses are being increased by \$4,417⁷⁸ to reflect amortizing the nonrecurring costs over 15-years and allocating 33.423 percent of the amortization expense to the outside city water system.

Pikeville also recorded as an expense \$29,836 of capital expenditures (i.e.; meters, meter vaults, etc.) that were used solely to provide service to its retail customers. Accordingly, repairs and maintenance expense is being reduced by \$29,836 to eliminate the capital expenditures that should not be recovered from the wholesale water customers, with no corresponding adjustment to depreciation. The total reduction to repairs and maintenance expense found reasonable in this discussion is \$129,342.⁷⁹

⁷⁶ Pikeville's responses to the Commission's June 10, 2019 Order, Item 10.

⁷⁷ \$11,006 (Telemetry Repairs at Toller Tank) + \$88,500 (Rehabilitation of Bob Atmos Storage Tank) = \$99,506.

⁷⁸ \$99,506 (Telemetry Repairs and Water Tank Rehabilitation) ÷ 15 (Years) = \$6,634 x 33.423% (Outside City Allocation Factor) = \$2,217. \$6,634 (Total Amortization) - \$2,217 (Outside System Allocation) = \$4,417.

⁷⁹ \$99,506 (Telemetry Repairs and Water Tank Rehabilitation) + \$29,836 (Capital Expenditures) = \$129,342.

Repairs and Maintenance Plant

In its Fiscal Year 2017 Trial Balance, Pikeville reported a repair and maintenance plant expense of \$30,632.⁸⁰ In its review of the general ledger, Commission Staff discovered that Pikeville had expensed the repair of a high service pump that cost \$24,264. We find that repairs and maintenance plant expense should be decreased by \$24,264 to eliminate the repair cost that the Commission classifies as nonrecurring for ratemaking purposes. Operating expenses are being increased by \$1,077⁸¹ to reflect amortizing the nonrecurring cost over 15-years and allocating 33.423 percent of the amortization expense to the outside city water system.

Combining the amortization of the nonrecurring costs results in a pro forma adjustment of \$8,252. Reallocating based upon the outside city allocation factor results in a pro forma adjustment of \$5,494.⁸²

Depreciation

Pikeville reported test-year depreciation expense of \$414,518.⁸³ To evaluate the reasonableness of the depreciation practices of small water utilities, the Commission has historically relied upon the report published in 1979 by the National Association of Regulatory Utility Commissioners (NARUC) titled Depreciation Practices for Small Water Utilities (NARUC Study). When no evidence exists to support a specific life that is inside

⁸⁰ Pikeville's responses to the Commission's June 10, 2019 Order, Item 10.

⁸¹ $\$24,264$ (High Service Pump Repair) \div 15 (Years) = $\$1,618$ x 33.423% (Outside City Allocation Factor) = $\$541$. $\$1,618$ (Total Amortization) - $\$541$ (Outside System Allocation) = $\$1,077$.

⁸² $\$4,417$ (Telemetry Repairs & Water Tank Rehabilitation) + $\$1,077$ (High Service Pump Repair) = $\$5,494$.

⁸³ *Id.*

or outside of the NARUC ranges, the Commission has historically used the mid-point of the NARUC ranges to depreciate utility plant.

Pikeville has not presented any supporting analysis or study to show that its depreciation lives are appropriate.⁸⁴ The Commission finds that Pikeville's test-year depreciation expense should be decreased by \$5,093⁸⁵ to reflect depreciating all of Pikeville's utility plant, including post-test-year plant, over the NARUC depreciation lives.

In its responses to Commission Staff's interrogatories, Pikeville did not specify that any of its inside-the-city water system plant depreciation was allocated to the outside-the-city system.⁸⁶ Upon review of Pikeville's depreciation schedules for both the inside-the-city and outside-the-city systems, the Commission confirmed that Pikeville did not allocate depreciation expenses between the two systems. Mr. Petty explained that in his review of the depreciation schedules for the inside-the-city and outside-the-city systems he was unable to identify detailed plant descriptions or the location of each plant item.⁸⁷ Furthermore, without the inside-the-city infrastructure (i.e.; treatment plant, transmission and distribution mains, pumping equipment, storage tanks, etc.) Pikeville would be unable to provide adequate service to its outside-the-city system. The Commission is decreasing depreciation expense by \$136,842⁸⁸ to reflect allocating 33.423 percent of the inside-the-city system depreciation expense to the outside-the-city water system.

⁸⁴ Pikeville's responses to Staff's Third Request, Item 9.

⁸⁵ Pikeville's responses to Staff's Second Request, Item 19.a.

⁸⁶ Pikeville's responses to the Commission's June 10, 2019 Order, Item 8.

⁸⁷ VHT at 3:19:01-3:22:18.

⁸⁸ $\$414,518 - \$5,093 = \$409,425$ (Pro Forma Depreciation) \times 33.423% (Outside City Allocation Factor) = \$136,842.

Summary Impact of Adjustments

After considering the test-year operating revenues and expenses, including appropriate adjustments found reasonable herein, the Commission has determined that the financial results of Pikeville's pro forma test-year operations would be as follows:⁸⁹

	Fiscal Year Ending 06/30/17	Pro Forma Adjustments	Pro Forma Operations
Operating Revenues	\$ 2,452,736	\$ (186,014)	\$ 2,266,722
Operating Expenses	2,429,546	(729,956)	1,699,590
Non Utility Operating Income	<u>\$ 23,190</u>	<u>\$ 543,942</u>	<u>\$ 567,132</u>

REVENUE REQUIREMENT

The Commission has historically applied a DSC method to calculate the Overall Revenue Requirement of water districts, water associations, and municipal-owned water utilities. This method allows for recovery of 1) cash-related pro forma operating expenses; 2) recovery of depreciation expense, a non-cash item, to provide working capital; 3) the average annual principal and interest payments on all long-term debts, and 4) working capital that is in addition to depreciation expense.

The Commission's calculation of the Revenue Requirement to be allocated between Pikeville and the wholesale customers is shown in the table below.

⁸⁹ See Appendix A for a detailed summary of this table.

Operation & Maintenance	\$ 1,421,513
Depreciation	272,583
Amortization	<u>5,494</u>
Pro Forma Operating Expenses	1,699,590
Plus: Average Annual Debt Principal and Interest Payments	116,499
Debt Coverage Requirement	<u>23,300</u>
Total Revenue Requirement	1,839,389
Less: Other Operating Revenue	<u>(60,384)</u>
Revenue Required from Rates	<u>\$ 1,779,005</u>

Average Annual Principal and Interest Payments. In calculating its revenue requirement, Pikeville used the Fiscal Year 2017 debt service of \$205,351 and calculated a debt service coverage of \$48,814.⁹⁰ At the close of Fiscal Year 2017, Pikeville reported the following three outstanding debt issuances: (1) General Obligation Series 2012C Bonds (Series 2012C Bonds); (2) United States Department of Agriculture (USDA) Series 2016A Bonds (Series 2016A Bonds); and (3) General Obligation Series 2017 Bonds (Series 2017 Bonds).⁹¹

Series 2012C Bonds. Pikeville explained that the purpose of this debt issuance was to refinance a debt that was issued in 2004, which was issued to refinance a debt that was originally issued in 1985.⁹² According to Pikeville, the following description was given for the purpose of the 1985 bond ordinance:

Whereas the portion of the system constituting the present water treatment plant facilities and appurtenances is inadequate to service the present and future needs; in order to aid in financing the construction and installation of major improvements and additions to such water treatment plant facilities and appurtenances; and proceeds thereof to be

⁹⁰ Pikeville's responses to Staff's Second Request, Item 16.c.

⁹¹ Pikeville's responses to the Commission's June 10, 2019 Order, Item 5.c.

⁹² Pikeville's responses to Staff's Third Request, Item 4.

applied to the construction and installation of certain waterworks improvements and additions.⁹³

Given the original purpose of the 1985 debt issuance, the Commission finds that 66.577 percent of the debt service for the Series 2012C Bonds should be assigned to the inside-the-city water system. The following schedule is the comparison of the three-year average debt service calculation for the total and allocated debt service for the Series 2012C Bonds.

Year	Total Debt Service	Inside City Allocation
2019	\$ 151,962	\$ 101,172
2020	\$ 149,162	\$ 99,308
2021	\$ 151,131	\$ 100,618
3-Year Avg.	\$ 150,752	\$ 100,366

Series 2016A Bonds. According to Pikeville, the proceeds of the Series 2016A Bonds was used to construct water and sewer services to the Kentucky Enterprise Industrial Park.⁹⁴ Pikeville states that the total cost of the Marion's Branch Water Sewer Project was \$4,743,496, of which \$3,813,633, or 80 percent, was for the water department and the remaining \$929,863, or 20 percent, was sewer-related. In their responses to Post-Hearing Requests for Information, Pikeville provided the engineering report for the Kentucky Enterprise Industrial Park project (Engineering Report)⁹⁵ and Mountain District provided a copy of Resolution 15-05-007, Authorization to Approve

⁹³ *Id.*

⁹⁴ Pikeville's responses to the Commission's June 10, 2019 Order, Item 5.c.

⁹⁵ Pikeville's responses to Staff's Post-Hearing Request, Item 10.

Letter of Support for the Marions Branch Water Line Extension Project (Mountain District Resolution).⁹⁶

Upon review of the Engineering Report and the Mountain District Resolution, the Commission determines, as shown in the calculation in Appendix B, that only 16.833 percent of the Series 2016A Bonds debt service should be included in the revenue requirement calculation. The following schedule is the comparison of the three-year average debt service calculation for the total and allocated debt service for the Series 2016A Bonds.

Year	Total Debt Service	Allocation
2019	\$ 95,270	\$ 16,084
2020	\$ 95,565	\$ 16,134
2021	\$ 95,834	\$ 16,180
3-Year Avg.	\$ 95,556	\$ 16,133

Series 2017 Bonds. Pikeville states that it used the proceeds of the Series 2017 Bonds to purchase and install radio read meters throughout the water system, to fund improvements at the athletic field, and to fund a wastewater treatment plant upgrade.⁹⁷ Given the stated purpose of the Series 2017 Bonds the Commission finds that the debt service for this issuance should not be included in its determination of Pikeville’s revenue requirement.

Three-Year Average Debt Service. The schedule below is the calculation of the three-year average debt service the Commission used in its revenue requirement determination.

⁹⁶ Mountain District’s responses to Pikeville’s Post Hearing Request.

⁹⁷ Pikeville's responses to the Commission’s June 10, 2019 Order, Item 5.c.

<u>Year</u>	<u>Series 2012C</u>	<u>Series 2016A</u>	<u>Series 2017</u>	<u>Total</u>
2019	\$ 101,172	\$ 16,084	\$ -	\$ 117,256
2020	\$ 99,308	\$ 16,134	\$ -	\$ 115,442
2021	\$ 100,618	\$ 16,180	\$ -	\$ 116,798
3-Year Average	\$ 100,366	\$ 16,133	\$ -	\$ 116,499

Rate Study

Pikeville had a two-step rate design, consisting of volumetric rates of \$1.68 per 1,000 gallons for the first 28,000,000 gallons purchased and \$1.30 per 1,000 gallons for purchases above 28,000,000 gallons.⁹⁸ Pikeville's proposal is to increase its volumetric rate for all water purchased by Mountain District to \$2.30 per 1,000 gallons. Pikeville's rate study follows the methodology discussed in the AWWA M54 Manual, *Developing Rates for Small Systems* (AWWA M54 Manual), but its requested revenue requirement is based on the DSC method.⁹⁹

According to Pikeville the AWWA M1 Manual describes the methodology that a water utility should follow to perform a Cost-of-Service Study (COSS) and also lists the customer demand data that is necessary to accurately calculate the cost of providing service to the different customer classifications.¹⁰⁰ Pikeville claims that it does not have the individual customer peak-day or peak-hour demands as required by the AWWA M1

⁹⁸ Pikeville's responses to the Commission's June 10, 2019 Order, Item 1, Elswick Testimony, Page 3.

⁹⁹ *Id.*, Pages 2-3.

¹⁰⁰ Pikeville's Brief, page 10.

Manual.¹⁰¹ Therefore, Pikeville performed a rate study following the AWWA M54 Manual, a methodology that does not require data on peak consumption.¹⁰²

Pikeville hired Samuel R. “Buddy” Petty, President of RateStudies, LLC. to prepare a comprehensive rate study.¹⁰³ According to Pikeville, Mr. Petty engaged staff from Pikeville and UMG to determine the most appropriate allocation factors for various expense categories using a collaborative process.¹⁰⁴ At the hearing Mr. Petty acknowledged that he did not obtain any records from Pikeville that would allow him to determine the appropriate allocation factors for the various expenses.¹⁰⁵ Pikeville claims that this lack of documentation does not impact the accuracy of the work that was originally performed and that the accuracy of most of the assignments can be determined at face value.¹⁰⁶

Pikeville argues that ultimately, Mr. Petty’s rate analysis is the only one presented in this case and although Pikeville was unable to produce peak-hour and peak-day demand information to produce a study based on AWWA’s M1 Manual, Mr. Petty was able to process the information that he was given and prepare – in his expert opinion – reasonable and reliable allocation factors.¹⁰⁷

¹⁰¹ *Id.*, pages 10-11.

¹⁰² Pikeville’s responses to the Commission’s June 10, 2019 Order, Item 1, Direct Testimony of Samuel R. Petty (Petty Testimony), page 2

¹⁰³ *Id.*, pages 1-2.

¹⁰⁴ Pikeville’s Brief, page 11.

¹⁰⁵ *Id.*

¹⁰⁶ *Id.*

¹⁰⁷ *Id.*, Page 12.

According to Mountain District, the burden is upon the applicant utility to show that a proposed increase in a rate or charge is just and reasonable.¹⁰⁸ Mountain District asserts that Pikeville's application fails to comply with the Commission's "known and measurable" ratemaking standard and that the data relied on by Pikeville is not verifiable or accurate.¹⁰⁹ Mountain District contends that it is up to Pikeville to justify its allocations and that it is not the responsibility of the Commission or Mountain District to formulate an allocation method.¹¹⁰ Mountain District agrees with Vice Chairman Cicero's statement at the hearing, "the burden is on Pikeville and without verification of the methodology, there is no way to allocate costs among the classes of users."¹¹¹

Mountain District points to the Commission's decision in Case No. 1990-00019, wherein the Commission made the following finding when rejecting Hardin County Water District No. 1's (Hardin County District No. 1) COSS:¹¹²

The Commission finds the record to be devoid of any evidence to support the reliability of this study. Its sponsor was unable to explain why various inputs or allocation factors were used. He was unfamiliar with accepted authorities on rate design and the basic principles to develop a cost-of-service study. He did not collect the data used for the study nor was he able to explain how it was collected.

None of Hardin District No. 1's other witnesses, furthermore, could explain the source of the data used in the cost-of-service study or why the Water District had ordered the

¹⁰⁸ Mountain District Brief page 6.

¹⁰⁹ *Id.* at 6-7.

¹¹⁰ *Id.* at 7.

¹¹¹ *Id.*, HTV 11:14:48.

¹¹² Mountain District Brief at 8, *quoting*, Case No. 1990-00019, *Petition of Hardin County Water District No. 1*, (PSC Ky. Feb. 21, 1991) ay 3.

study's preparer to use certain inputs and cost allocation factors.

Utility rates should not be based on a hunch and a prayer. The proponent of rates should be able to explain how its rate proposal was derived. Hardin District No. 1 cannot. Unable to assess the accuracy or reliability of the cost-of-service study, the Commission has no choice but to disregard it.¹¹³

In Hardin District's next rate case, the Commission was unable to verify the accurateness of Hardin District's COSS because Hardin District was unable to produce its accounting workpapers that supported its allocations. The Commission found that an accurate COSS cannot be prepared when the utility cannot determine the components of an expense category.

In Case No. 2002-00022, Pikeville presented a COSS that it described as a fully allocated COSS, which was loosely based on the generally recognized commodity-demand method.¹¹⁴ In that proceeding the Commission found numerous flaws with Pikeville's proposed COSS and little evidence in the record to support the majority of Pikeville's under lying assumptions.¹¹⁵ For these reasons the Commission ultimately rejected Pikeville's proposed COSS and accepted Mountain District's modified inch mile method.¹¹⁶

¹¹³ See Case No. 90-019, *In the Matter of the Petition of the Hardin County Water District No.1 for a Certificate of Convenience and Necessity; Approval of Financing of the Construction and the Issuance of Bonds; and the Approval of Rates to be Charged its Retail and Wholesale Customers* (Ky. PSC Feb. 21, 1991) at 20-21.

¹¹⁴ See Case No. 2002-00022, *Proposed Adjustment of Wholesale Water Service Rates of the City of Pikeville, Kentucky* (Ky. PSC Oct. 18, 2002) at 31.

¹¹⁵ *Id.* at 31-36.

¹¹⁶ *Id.* at 36.

When responding to interrogatories concerning the calculations of the COSS allocation percentages, Pikeville explained that the allocations were the product of a collaborative effort between Mr. Petty and the following Pikeville representatives: Grondall Potter, Philp Elswick, Tonya Taylor, Brad Slone, Donnie Slone, Robbie Bentley, and Rebecca Hamilton (COSS Team).¹¹⁷ According to Mr. Petty this collaborative effort involved the COSS Team discussing each individual item (expense) that was listed on a spreadsheet and agreeing as a group as to how each cost would ultimately be allocated in the COSS. The COSS Team did not memorialize the discussions or maintain records to support the calculation of each expense allocation.

Mr. Petty agreed that the expense allocations used in his rate study cannot be objectively quantified or proven. The rate study allocations were developed by using the system knowledge and experience of each COSS Team member rather than documented empirical data. Pikeville's position that the accuracy of most of the assignments can be determined at face value fails to comply with the Commission's long-held ratemaking standard of known and measurable.

The Commission reaffirms its position in Case No. 90-019, that utility rates should not be based on a hunch and a prayer, which Pikeville is attempting to accomplish with its proposed rate study. Given the lack of supporting evidence, the Commission finds that Pikeville has failed to meet its burden of proof that its rate study produces a fair, just, and reasonable wholesale water rate, and therefore, Pikeville's proposed rate study should be rejected.

¹¹⁷ Pikeville's responses to Mountain District's First Request for Information, Item 10.

In the absence of an accepted rate study, the Commission is allocating a portion of the revenue requirement calculated herein using the ratio of wholesale water sales in gallons to total system sales in gallons for Fiscal Year 2017. In calculating a fair, just, and reasonable wholesale rate, the Commission finds that Pikeville should charge the same wholesale rate to both of its wholesale customers, Mountain District and Southern District. Accordingly, 68.7 percent or \$1,806,074 of the revenue requirement is being allocated to the wholesale customers, resulting in a wholesale rate of \$1.97 per 1,000 gallons, as calculated below:

Wholesale Water Sales - Gallons	619,140,000
Divide by: Total Inside Water Sales	<u>900,812,417</u>
% of Wholesale water Sales	68.7%
Multiplied by: Revenue Requirement	<u>1,779,005</u>
Allocated Revenue Requirement to Wholesale Rate	1,222,176
Divided by: Wholesale Water Sales	<u>619,140,000</u>
Wholesale Water Rate per 1,000 Gallons	<u>\$ 1.97</u>

Rate Case Expenses

A utility may properly recover reasonable rate case expenses as a cost of doing business.¹¹⁸ The Commission has generally permitted rate recovery of a reasonable level of rate case expenses but has disallowed such expenses when a utility has failed to provide adequate documentary evidence of the incurrence of the expense.¹¹⁹ The Commission has also disallowed such expenses as unreasonable when related to a

¹¹⁸ See *Driscoll v. Edison Light & Power Co.*, 307 U.S. 104, 120 (1939).

¹¹⁹ Case No. 2008-00250, *Proposed Adjustment of the Wholesale Water Service Rates of Frankfort Electric and Water Plant Board* (Ky. PSC Apr. 6, 2009).

poorly or improperly prepared rate application¹²⁰ and in cases where the utility failed to justify the high level of expenses for relatively simple alternative rate filings.¹²¹

In its February 21, 2019 tariff filing, Pikeville proposed a rate case expense surcharge mechanism. The filing proposed to assess a surcharge over 36 months to recover any rate case expenses it may incur to participate in and defend its proposed rates. In the tariff filing, Pikeville used rate case expenses totaling \$115,200¹²² as demonstrative of its proposed methodology.

In Case No. 2009-00373, *Proposed Adjustment of the Wholesale Service Rates of Hopkinsville Water Environment Authority*, the Commission analyzed whether the special counsel fees were part of reasonable rate case expenses and capped the rate case expense.¹²³ The Commission evaluates the prudence of rate case expense on a case-by-case basis.¹²⁴ In the Hopkinsville case, the Commission allocated the cost of performing a COSS because it related to all the customers and reduced the special counsel fees that were related to the COSS because it was performed after the application and not used to develop the proposed rates at issue. The high level of rate case expense compared to the complexity of the issues, and the level of rate case expenses for similar

¹²⁰ Case No. 8783, *Application of Third Street Sanitation, Inc. for an Adjustment of Rates Pursuant to the Alternative Procedural for Small Utilities* (Ky. PSC Nov. 14, 1983).

¹²¹ Case No. 9127, *Application of Sargent and Sturgeon Builders, Inc., Gardenside Subdivision Sewer Division, for a Rate Adjustment Pursuant to the Alternative Rate Filing for Small Utilities* (Ky. PSC Mar. 25, 1985).

¹²² \$3,200 (Monthly Surcharge) x 36-Months = \$115,200.

¹²³ Case No.2009-00373, *Proposed Adjustment of the Wholesale service Rates of Hopkinsville Water Environment Authority* (Ky. PSC July 2, 2010).

¹²⁴ *Id.* at 5–6.

cases, were factors the Commission reviewed in finding that Hopkinsville's expense related to special counsel fees should be limited to \$50,000.¹²⁵

Pikeville provided copies of invoices showing that actual costs incurred in conjunction with this rate case was \$85,814, plus an additional estimated \$3,675 for additional legal work to be performed through the final order in this case, for a grand total of \$89,489.¹²⁶

Pikeville hired Mr. Petty to prepare a comprehensive rate study in order to establish a wholesale rate for Mountain District. The Commission discovered the following deficiencies in Mr. Petty's rate study: (1) the failure to retain written records to record the COSS Team discussions or to support the calculation of the expense allocations that the COSS Team developed; (2) the expense allocations used in his rate study cannot be objectively quantified or proven; and (3) the rate study fails to comply with the Commission's long-held ratemaking standard of known and measurable. For these reasons the Commission finds that the cost of the rate analysis should not be recovered by Pikeville through the rate case surcharge.

Pikeville has proposed to assess a surcharge over 36 months to recover any rate case expenses it may incur to participate in and defend its proposed rates. However, when there is no evidence to support an alternative amortization period, the Commission amortizes an intangible regulatory asset or liability identified in a rate proceeding over the

¹²⁵ *Id.* at 9–13.

¹²⁶ Pikeville's September 20, 2019, supplemental responses to Staff's Second Request, Item 34. \$, page 13. \$64,394 (Attorney Fees) + \$25,095 (Consulting Fees) \$89,448.

anticipated life of the utility rates approved in that proceeding.¹²⁷ The life is generally based on the frequency of the utility's historic rate filings. Pikeville last increased Mountain District's wholesale rate in 2009, making the frequency of wholesale rate increase ten years. This evidence suggests that a ten-year amortization period may be appropriate; however, it is the Commission's opinion that the rates approved in this proceeding will become obsolete after five years due to changes that will likely occur to Pikeville's cost of providing wholesale water service. Accordingly, absent a more reasonable amortization period, the Commission is allowing Pikeville to recover its allowable rate case expense of \$64,394 over 60-months. The 60-month surcharge that Pikeville is authorized to charge Mountain District and Southern District is \$537 per month.¹²⁸

The Commission, after consideration of the evidence of record and being sufficiently advised, finds that:

1. The rates proposed by Pikeville would produce revenues in excess of the revenues found reasonable herein and should be denied.
2. Pikeville should be permitted to recover \$64,394 for rate case expenses related to legal fees.
3. The rates set forth in the Appendix C to this Order are fair, just, and reasonable and should be approved for the provision of wholesale water service to Pikeville for services rendered on and after September 5, 2019.

¹²⁷ Case No. 2013-00314, *Alternative Rate Adjustment Filing of Par-Tee LLC Db a Perry Park Resort Sewer Utility* (Ky. PSC Staff Report issued Dec. 6, 2013; Final Order issued Feb. 19, 2014) Staff's finding pages 13-14 of its report; The Commission ordered that: The findings contained in the Staff Report are adopted and incorporated by reference into this Order as if fully set out herein.

¹²⁸ \$64,394 (Attorney Fees) ÷ 60 (Months) = \$1,073 ÷ 2 (Wholesale Customers) = \$537 (Monthly Rate Case Expense Surcharge).

4. Pikeville District should be authorized to assess a monthly surcharge of \$537 each to Mountain District and Southern District for a period of 60 months to recover \$64,394 for rate case expenses.

5. Within 30 days of the date of this Order, Pikeville should file with the Commission a report on the amount of excess revenues collected from September 5, 2019, through the date of this Order and a plan for refunding these revenues. This report shall include interest for the period the excess revenues were collected at the average of the Three-Month Commercial Paper Rate as reported in the Federal Reserve Bulletin and the Federal Reserve Statistical Release. Pikeville shall include in its report its plan to refund the excess revenues collected and the associated interest within 60 days of the date of this order, as required by KRS 278.190(4).

6. Pikeville should file a revised tariff setting out these rates as approved and remove language pertaining to the possibility of a refund if a lower rate is determined from its tariff.

IT IS THEREFORE ORDERED that:

1. The wholesale rates proposed by Pikeville are denied.

2. The rates and charges found reasonable herein and set forth in Appendix C to this Order are approved for the provision of wholesale water service rendered by Pikeville to Mountain District and Southern District on and after September 5, 2019.

3. Within 30 days of the date of this Order, Pikeville shall file with the Commission a report on the amount of excess revenues collected from September 5, 2019, through the date of this Order and a plan for refunding these revenues. This report shall include interest for the period the excess revenues were collected at the average of

the Three-Month Commercial Paper Rate as reported in the Federal Reserve Bulletin and the Federal Reserve Statistical Release. Pikeville shall include in its report its plan to refund the excess revenues collected and the associated interest within 60 days of the date of this order, as required by KRS 278.190(4).

4. Within 20 days of the date of this Order, Pikeville shall file with this Commission, using the Commission's electronic Tariff Filing System, revised tariff sheets setting out the rates approved herein and reflecting that they were approved pursuant to this Order.


5. Any documents filed pursuant to ordering paragraph No. 3 and 4 of this Order shall reference the case number of this matter and shall be retained in the utility's general correspondence files.

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

By the Commission

ENTERED
DEC 19 2019
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:


Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2019-00080 DATED **DEC 19 2019**

Pro Forma Income Statement

	Fiscal Year Ending 06/30/17	Pro Forma Adjustments	Administrative Rev/Exp	Reallocations	Pro Forma Operations
Operating Revenues:					
Revenues from Water Sales:					
Residential Water City	\$ 509,291				\$ 509,291
Commercial Water City	253,583				253,583
Public Authority Wt City	321,007				321,007
Multiple Family City Residential	95,725				95,725
Multiple Family Commercial	28,658				28,658
W/Wholesale District/Rev	998,074				998,074
Metered Water Sales:	2,206,338	0			2,206,338
Other Water Revenues:					
Bad Debt Recovery	290		(290)		0
Water Tap Fee	24,510		(24,510)		0
Water Penalty	10,911		(10,911)		0
Water Special Revenue	150,303	(150,303)			0
Special Revenue	47,927				47,927
Water S C	12,457				12,457
Total Other Water Revenues	246,398	(150,303)	(35,711)	0	60,384
Total Operating Revenues	2,452,736	(150,303)	(35,711)	0	2,266,722
Operating Expenses:					
Operation & Maintenance Expense					
Gasoline	144,174	(144,174)			0
Bank Charges-Water Revenue	3,890		(3,883)		7
Provision For Bad Debt	1,158		(1,158)		0
Dues	850		(848)		2
Freight/Postage	1,349		(1,347)		2
Insurance	29,134			(11,663)	17,471
Office Supplies	2,489		(2,484)		5
Public Works Water - UMG MGT Fee	1,162,040		(57,997)	(49,416)	1,054,627
Prof Service Other	777		(776)		1
Ut Monthly Billing/Professional Services	3,803		(3,796)		7
Umg...Services	141,565	(23,091)		(39,598)	78,876
Rent-Easements	376		(375)		1
Purchase Software	1,845		(1,842)		3
Repairs/Maintenance	139,077	(129,342)		(3,254)	6,481
Repairs And Maintenance Plant	30,632	(24,264)		(2,128)	4,240
Telephone/Public Works	8,206	(6,129)			2,077
Electric	299,596			(46,328)	253,268
City Utilities	4,445				4,445
Workers Comp	286		(286)		0
Salaries & Wages	21,294		(21,294)		0
Employee Benefit Insurance	7,567		(7,567)		0
Pension Matching	8,719		(8,719)		0
Operation & Maintenance Expense	2,013,272	(327,000)	(112,372)	(152,387)	1,421,513
Depreciation	414,518	(5,093)		(136,842)	272,583
Amortization		8,252		(2,758)	5,494
Taxes other than Income:					
Payroll Tax	1,629		(1,629)		0
Unemployment Tax	127		(127)		0
Utility Operating Expenses	2,429,546	(323,841)	(114,128)	(291,987)	1,699,590
Net Utility Operating Income	\$ 23,190	\$ 173,538	\$ 78,417	\$ 291,987	\$ 567,132

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2019-00080 DATED **DEC 19 2019**

Allocation of 2016A Bonds

	Project Cost	Overhead Allocations		Cost Breakdown
		Factors	\$	
General	83,830	4.001%	22,995	106,825
Water Line	718,200	34.277%	196,997	915,197
Valves and Fittings	232,000	11.073%	63,639	295,639
Storage Tank	861,250	41.104%	236,232	1,097,482
Pump Station	200,000	9.545%	54,857	254,857
	2,095,280			
Overhead	574,720	100.000%	574,720	
Project Total	2,670,000			2,670,000
Storage Tank				1,097,482
Pump Station				254,857
Total				1,352,339
Multiplied by: 1/3 MWD Allocation				33.333%
Construction Cost Allocated to MWD				450,780
Percentage of Loan - Wholesale	\$		450,780 / \$	2,670,000 =
				16.883%

APPENDIX C

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2019-00080 DATED **DEC 19 2019**

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

Wholesale Water Rates
Mountain Water District and
Southern Water and Sewer District

Volume Charge per 1,000 Gallons	\$ 1.97
Rate Case Expense Surcharge for 60 Months	\$537 Per Month

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*City of Pikeville
243 Main Street
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*Honorable John N Hughes
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124 West Todd Street
Frankfort, KENTUCKY 40601

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Pikeville, KY 41502-3157

*M. Todd Osterloh
Sturgill, Turner, Barker & Moloney, PLLC
333 West Vine Street
Suite 1400
Lexington, KENTUCKY 40507

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC PROPOSED ADJUSTMENT OF)	
THE WHOLESALE WATER SERVICE RATES)	CASE NO.
OF THE CITY OF PIKEVILLE TO MOUNTAIN)	2019-00080
WATER DISTRICT)	

ORDER

By petition filed on January 13, 2020, the city of Pikeville (Pikeville), requests a rehearing of the Commission’s final Order issued on December 19, 2019 (Final Order), pursuant to KRS 278.400. Among other things, the Final Order authorized a wholesale water rate of \$1.97 per 1,000 gallons and for Pikeville to be able to recover its allowable rate case expense of \$64,394 through a 60-month surcharge of \$537 to be charged to Mountain Water District (Mountain District) and to Southern Water and Sewer District (Southern District).

Pikeville raises multiple issues on rehearing, which are addressed below. Mountain District did not file a response to Pikeville’s rehearing petition. This matter stands submitted for a decision.

DISCUSSION AND FINDINGS

Legal Standard

KRS 278.400 establishes the standard of review of applications for rehearing. KRS 278.400 provides that, upon rehearing, a party may offer additional evidence that could not with reasonable diligence have been offered at the time of the original hearing. Rehearing does not present parties with the opportunity to relitigate a matter fully

addressed in the original Order. KRS 278.400 is intended to provide closure to Commission proceedings by limiting rehearing to new evidence not readily discoverable at the time of the original hearings. Thus, final orders remain undisturbed absent extraordinary circumstances, such as a material error or omission in the order. KRS 278.400 provides an opportunity for the Commission to address any errors or omissions in an order.

Customer Allocation Factor

Citing the absence of a supporting study or analysis, the Commission found that Pikeville's fixed shared costs would not vary with the amount of water that Pikeville either produced or sold.¹ In prior proceedings the Commission found that a more equitable allocation method would be the number of customers that are served by each division (Customer Allocation Factor). The Commission finds that Pikeville's shared fixed costs should be reallocated using a five-year average Customer Allocation Factor. Using the five-year average customer allocation factor the Commission allocated 33.423 percent of the shared fixed costs to the outside-the-city system and 65.577 percent to the inside-the-city system. By reallocating the shared fixed costs between the two customer classes, the Commission decreased the operation and maintenance expense allocated to inside-the-city customers by \$106,059.

Pikeville explains that historical test-year ratemaking is premised on the "matching principle" of accounting, where the relationship of revenues and expenses is established.²

¹ Final Order at 8.

² Petition for Rehearing by City of Pikeville (Pikeville Rehearing Petition) filed January 13, 2020, at 8.

Pikeville's interpretation of the "matching principle" is that all revenues, expenses, rate base components, plant additions, and capital items are updated to the same period.³ Pikeville argues that the Commission is violating the matching principle by applying a customer allocation factor that is based on an average calculated with customer data from 2014 to 2018 to fiscal year 2017 operating expenses.⁴

Pikeville notes that the Commission cited numerous cases to support the use of a customer allocation factor to allocate to Pikeville's shared fixed costs. However, in none of the cases cited, Pikeville argues, did the Commission or its Staff use a multi-year average to determine the appropriate allocation factor of shared fixed costs.⁵ Pikeville requests that the Commission revise its Order to reflect allocating the shared fixed costs between the two systems using the 2017 fiscal year customer allocation factor.⁶

The Commission acknowledges that the Final Order failed to give a full explanation for the reason the Commission decided to use a five-year average Customer Allocation Factor to allocate the shared fixed costs between the outside-the-city and the inside-the-city systems. The Commission finds that rehearing should be granted to clarify the Final Order as discussed below.

The common definition of a fixed cost, is a cost that does not change with increases or decreases in units of production volume.⁷ For a water utility water production would

³ *Id.*

⁴ *Id.*

⁵ *Id.*

⁶ *Id.*

⁷ <https://corporatefinanceinstitute.com/resources/knowledge/accounting/fixed-and-variable-costs/>

not directly impact a fixed cost, but changes in the number of customers served (increases or decreases) over time will have some degree of impact. Even though the customer level does have some impact, a fixed cost would not vary widely from year to year, but would remain constant throughout a relevant range.⁸

In reviewing the historical customer data, the Commission notes that for every year in the five-year period there is variation between the customers served by each division which would result in differences in the annual fixed cost allocation factor. A five-year customer allocation factor is an average of the highs and lows that have occurred over a relevant range. For this reason the Commission finds that the use of five-year average customer allocation factor results in a reasonable cost allocation between the two water systems. Therefore, Pikeville's request for rehearing on this issue is denied.

Allocations of Repairs and Maintenance Plant and Insurance

Pikeville explains that when the Commission allocated the shared fixed costs between the inside- and outside-the-city customer classifications it started its adjustment based on the total inside-the-city and outside-the-city expense.⁹ According to Pikeville the Commission failed to add the outside-the-city allocated expenses of \$1,888 (Ross Valve Manufacturing, Eco Lab, and ML Johnson) before applying the Customer Allocation Factor.¹⁰ Similarly, Pikeville requests the Commission to correct the formulas for calculating the fixed shared cost adjustments to Insurance Expense and the Repairs and Maintenance Plant Expense.¹¹ In reviewing Pikeville's response to the Commission

⁸ http://economics.fundamentalfinance.com/micro_costs.php

⁹ Pikeville Rehearing Petition, at 9.

¹⁰ *Id.*

¹¹ *Id.*

Staff's First Request for Information, the Commission agrees with Pikeville that \$1,888 should be included to the repairs and maintenance expense before applying the customer allocation factor. Including this amount into the allocation adjustment results in an increase to repairs and maintenance expense of \$1,257, which is *de minimis* because it does not materially impact the calculation of Pikeville's wholesale rate. Further, the formulas used by the Commission to calculate the cost allocations between the inside-the-city and the outside-the-city systems are correct.¹²

For the above reasons, the Commission finds that the Pikeville failed to establish a material error or omission in the Final Order, or that the Final Order was unreasonable or unlawful, and therefore fails to satisfy the standard for rehearing. Pikeville's request for rehearing on this issue is denied.

Electric Expense based on Sales not Production

The only variable shared cost reported by Pikeville was electric expense.¹³ The Commission found that without the pumping stations and the storage tanks located inside the city system, Pikeville would be unable to provide water service to the outside-the-city system.¹⁴ Using the five-year average of water produced, the Commission calculated an electric cost per gallon produced of \$0.0000281. Using the average inside-the-city water

¹² Repairs and Maintenance Plant: $\$6,368$ (Net Repairs and Maintenance Plant) \times -33.253% (5-Year Outside Customer Allocation Adjustment) = $\$(2,128.38)$ (Outside-the-City Allocation) + $\$6,368$ (Net Repairs and Maintenance Plant) = $\$4,239.62$ (Inside-the-City Allocation) \div $\$6,368$ (Net Repairs and Maintenance Plant) = 66.577% .

Insurance: $\$34,896$ (Total Insurance) \times -33.253% (5-Year Outside Customer Allocation Adjustment) = $\$(11,663.29)$ (Outside-the-City-Allocation) + $\$34,896$ (Total Insurance) = $\$23,232.71$ (Inside-the-City Allocation) \div $\$34,896$ (Total Insurance) = 66.577% .

¹³ Chemical expense is also a variable cost, but it is embedded in the UMG Management Fee so an additional adjustment is unnecessary.

¹⁴ Final Order at 9.

sales the Commission calculated a decrease to electricity expense for the inside-the-city system of \$46,328.

Pikeville claims that the methodology employed by the Commission leaves a void whereby Pikeville would be unable to recover for electric expense associated with water produced but not sold.¹⁵ Pikeville further claims that the Commission is violating the matching principle by using a five-year average of data for water production and water sales.¹⁶

In the test year there is a difference of 380,001,700 gallons or 32.9 percent between water production of 1,155,123,700 gallons and water sales of 775,122,000. In its Petition for Rehearing Pikeville only identifies the void in electric expense associated with water produced but not sold without fully explain the cause of the excessive difference water sales and production or to provide evidence as to why the cost associated with this difference should be recovered from its wholesale customers. Accordingly, the Commission is denying Pikeville's request for rehearing on this issue.

Customer Related Cost Adjustments

Pikeville claims that the Commission identified certain expenses as being customer-related costs and without giving a reasonable explanation as to why some customer-related costs should be totally recovered from the retail water customers, while others are allocated using the number of meters in Pikeville's system.¹⁷ Pikeville argues that the evidence of record does not support the Commission's decision that employee

¹⁵ Pikeville Rehearing Petition at 10.

¹⁶ *Id.* at 11.

¹⁷ *Id.* at 13.

related expenses (salaries and wages, workers compensation, employee benefit insurance, pension, payroll tax, and unemployment tax) should be recovered exclusively from the retail customers. Pikeville claims that its employees perform the following duties that are directly related to providing wholesale water service to Mountain District (take calls from Mountain District, prepare work orders for maintenance of facilities benefiting Mountain District, send bills to Mountain District, and receive payments from Mountain District).¹⁸

According to Pikeville, the Commission erroneously calculated the allocation factor for customer-related costs based on Mountain District receiving wholesale service through 9 wholesale water meters when actually there are 11 master meters providing wholesale service to Mountain District.¹⁹ This correction would increase the allocation factor for customer-related costs from 0.181 percent to 0.221 percent.²⁰

Pikeville claims that the Commission eliminated recovery of certain UMG Management Fee expenses twice. First the Commission determined that the overall UMG Management Fee expense that could be recovered from the inside-the-city system should be reduced from \$1,162,040 by \$49,416 to a total of \$1,112,624. Next the Commission eliminated \$58,102 of customer-related administrative costs from the UMG Management Fee. Samuel "Buddy" Petty calculated this administration component by multiplying UMG Management fee of \$1,162,040 by 5 percent. Pikeville argues the

¹⁸ *Id.*

¹⁹ *Id.* at 13–14.

²⁰ *Id.* at 14.

5 percent factor should be multiplied by the reduced fee of \$1,112,642 for a revised customer-related administrative cost of \$55,632.

The Commission agrees with Pikeville in that the Commission used the wrong number of wholesale meters when it calculated the allocation factor for customer-related costs. Using 11 wholesale master meters increases the allocation factor from 0.181 percent to 0.221 percent. Increasing the allocation factor to 0.221 percent would increase the revenue requirement by \$118, which is *de minimis* because it does not materially impact the calculation of Pikeville's wholesale rate. Further, the Commission in its Order noted the numerous deficiencies in the allocation factors used by Mr. Petty in his proposed rate analysis. Although the administration component of the UMG Management is based on an unsupported factor, the Commission recognizes that some portion of the UMG management fee relates to administrative costs that would not be recovered through the wholesale rate. For this reason the amount identified by Mr. Petty in his study was viewed as a fixed cost that would not vary with changes in the allocation of the UMG Management fee between the various city departments.

For the above reasons, the Commission finds that the Pikeville failed to establish a material error or omission in the Final Order, or that the Final Order was unreasonable or unlawful, and therefore fails to satisfy the standard for rehearing. Pikeville's request for rehearing on this issue is denied.

Nonrecurring Expenditures

The Commission reduced repairs and maintenance expense by \$99,506 (the telemetry repairs at Toller and the rehabilitation of the Bob Amos tank) finding these items

are nonrecurring that should have been amortized rather than expensed.²¹ It also reduced maintenance/repairs plant expense by \$24,264 finding that the repair of a high service pump is a nonrecurring expenditure. The Commission amortized the nonrecurring expenditures over a 15-year life.

Pikeville claims that over the past 15 years, it has consistently reported similar types of expenditures as operating expenses, rather than as nonrecurring costs that would be amortized.²² Because Pikeville expensed (rather than amortized) these expenditures that have occurred within the past 14 years, the fiscal year 2017 operations and maintenance expense is understated.²³ Accordingly, Pikeville argues that if the Commission determines that similar expenses within the test year must be amortized over a 15-year period, effectively reducing the revenue requirement for the inside-the-city system by \$118,206, the Commission should increase amortization expense by \$16,653 to reflect amortizing past nonrecurring expenditures that Pikeville originally expensed.²⁴

The rule against retroactive ratemaking is a generally accepted principle of public utility law which recognizes the prospective nature of utility ratemaking. It prohibits regulatory commissions from setting future rates to allow a utility to recoup past losses or to recover expenses incurred in prior years. Including the past nonrecurring expenditures in the current revenue requirement of Pikeville is a violation of retroactive ratemaking. Accordingly, the Commission is denying Pikeville rehearing request for this issue.

²¹ Final Order at 20.

²² Pikeville Rehearing Petition at 16.

²³ *Id.* at 17.

²⁴ *Id.*

Depreciation Expense Allocation to the Outside-the-City System

The Commission decreased depreciation expense by \$136,842 to allocate a part of the inside-the-city system that would be used for outside-the-city customers. The Commission's reduction was based on the application of the Customer Allocation Factor to the total pro forma depreciation expense of \$409,425. The total revenue requirement for inside-the-city customers was reduced by other operating revenue of \$60,384 which included reported special revenues of \$47,927. Pikeville now claims that special revenues represents the amount credited to inside-the-city depreciation that it assigned to its outside-the-city depreciation expense.²⁵ According to Pikeville, because depreciation expense by \$136,842, it would be inappropriate also to include an adjustment for the \$47,927 in other operating revenue that is credited to inside-the-city revenue from outside-the-city depreciation.²⁶

Pikeville was specifically requested to identify all shared revenues and expenses that were allocated between the inside-the-city and the outside-the-city systems.²⁷ In responding to the request Pikeville failed to identify depreciation as being a shared expense that was allocated.²⁸ Further, Pikeville was requested to identify individual revenue subaccounts in the fiscal year ending June 30, 2017 Trial Balance that combine to arrive at the total inside revenue - 2017 of \$2,256,339.²⁹ Pikeville provided a list of the

²⁵ *Id.* at 18.

²⁶ *Id.*

²⁷ Pikeville's responses to Commission Staff's First Request for Information, Item 8.a.

²⁸ *Id.*

²⁹ Pikeville's responses to Commission Staff's Second Request for Information, Item 16.e

revenues, but did not explain that the special revenues of \$47,927 was actually the allocation of depreciation to the outside-the-city system.³⁰

KRS 278.400 provides closure to Commission proceedings by limiting rehearing to new evidence not readily discoverable at the time of the original hearings. For this reason the Commission is denying Pikeville's request for rehearing on the depreciation allocation issue.

Debt Service 2016A Bonds

Pikeville used the proceeds from its United States Department of Agriculture (USDA) Series 2016A Bonds to construct water and sewer services to the Kentucky Enterprise Industrial Park.³¹ The total cost of the Marion's Branch Water Sewer Project (Marion Branch Project) was \$4,743,496, of which \$3,813,633, or 80 percent, was for the water department and the remaining \$929,863, or 20 percent, was sewer-related.³² Using Pikeville's engineering report and Mountain District's provided Resolution 15-05-007, the Commission determined that only 16.833 percent of the Series 2016A Bonds debt service should be included in the revenue requirement calculation.³³

Pikeville notes that the Commission's calculation is based on the Marion Branch Project cost for the storage tank and pump station, but does not include cost of the water line, valves, and fittings.³⁴ Pikeville argues that with its decision, the Commission is

³⁰ *Id.*

³¹ Final Order at 25.

³² *Id.*

³³ *Id.* at 26.

³⁴ Pikeville Rehearing Petition, page 18.

implicitly saying that Mountain District does not benefit from the costs for the water line, valves, and fittings, but the evidence of record demonstrates that Mountain District would be unable to receive service from Marion Branch Project tanks and pump station without the water line, valves, and fittings.³⁵ Pikeville argues that by including the 16.833 percent debt service for the Marion Branch Project that Mountain District should be responsible for in its revenue requirement calculation, the Commission's is reducing Mountain District's responsibility for the Marion Branch Project from 16.883 percent to 11.599 percent.³⁶ Pikeville requests the Commission to clarify that MWD is responsible for one-third of the total cost of the Marion Branch Project, and to calculate the impact of that debt service allocation to Pikeville's wholesale rate after other inside-the-city expenses are allocated to Mountain District.³⁷

The Commission acknowledges that the Final Order did not fully explain why the Commission included the 16.833 percent of the Series 2016A Bonds in the revenue requirement calculation and shared between Pikeville and Mountain District. The Commission finds that rehearing should be granted to clarify the Final Order as discussed below:

The Marion Branch Project facilities have been in service for approximately four years and the only documented time that Mountain District used the Marion Branch Project facilities was for the week of August 7, 2018, through August 15, 2018. Mountain District purchased approximately 1,687,900 gallons of water to assist in providing water

³⁵ *Id.* at 19.

³⁶ *Id.* at 20.

³⁷ *Id.*

service in the Indian Hill area when a river crossing went out of service.³⁸ Given the lack of documentation of Mountains District's use of the Marion Branch Project facilities, it would be unreasonable to recover the full 16.833 percent of the Series 2016A Bonds from Mountain District. For the reasons discussed above, the Commission is denying Pikeville's request for rehearing on this issue.

Rate Case Surcharge

Pikeville proposed to assess a rate case surcharge over 36 months to recover any rate case expenses incurred in this current case. The Commission explained that surcharge amortization life is generally based on the frequency of the utility's historic rate filings.³⁹ A review of Pikeville's filed tariff showed that Mountain District's wholesale rate was last changed in 2009, making the frequency of wholesale rate increases ten years. The Commission noted that the evidence suggests that a ten-year amortization period may be appropriate; however, in the Commission's opinion the rates approved in this proceeding would become obsolete after five years due to changes that will likely occur to Pikeville's cost of providing wholesale water service.⁴⁰ Absent a more reasonable amortization period, the Commission allowed Pikeville to recover its allowable rate case expense of \$64,394 over 60-months for a monthly surcharge of \$537 to be recovered from Mountain District and Southern District.⁴¹

³⁸ Pikeville's Response to the Commission Staff's Third Request for Information, Item 5.d.

³⁹ Final Order at 34.

⁴⁰ *Id.*

⁴¹ *Id.*

Pikeville notes the Commission's acknowledgement that the wholesale rates approved in this current case will be obsolete after five years due to changes that will likely occur to Pikeville's cost of providing wholesale water service.⁴² Pikeville reasons that it is illogical to maintain that an appropriate amortization period is based on the anticipated life of the approved utility rates, only to set an amortization period ending after those rates have become obsolete.⁴³ Pikeville argues that a 36-month amortization period supports the Commission's recent emphasis that utilities should evaluate the need for more frequent rate cases.⁴⁴ By amortizing Pikeville's rate case expense over a five-year period, the Commission is signaling that rate cases need not be filed more frequently than every five years, which appears to be inconsistent with the Commission's encouragement that "[e]ach water utility should evaluate the need for more frequent rate cases."⁴⁵

According to Pikeville by using a surcharge mechanism there is no ability for Pikeville to "over-recover" as if the rate case amortization is built into the volumetric rate.⁴⁶ Pikeville argues that if the rate case amortization is recovered through the volumetric there is an incentive to use an amortization period that is consistent with the anticipated rate case cycle because if a utility is permitted to amortize the expense over a shorter period than when it next files a rate case, the utility would (in theory) over-recover on that

⁴² Pikeville Rehearing Petition at 22.

⁴³ *Id.*

⁴⁴ *Id.* at 23–24.

⁴⁵ *Id.* at 24.

⁴⁶ *Id.*

single expense.⁴⁷ Pikeville will not be able to “over-recover” because the term of the surcharge will expire when the full-amount of the rate case expense is recovered.⁴⁸

The historical evidence supports an amortization period that is longer than three years. Pikeville’s last fully litigated wholesale rate case occurred in 2002.⁴⁹ In the 17 years since Case No. 2002-00022 was litigated, Pikeville has increased its wholesale rate twice, once in 2009 and again in 2019, which results in an average of 8.5 years between wholesale rate increases. Pikeville has failed to document why a three-year amortization period is warranted other than its anticipation of the life of the new wholesale rate. The Commission finds that basing an amortization period on anticipation fails to meet the ratemaking criteria of being known and measurable. Furthermore, using an amortization period shorter than the period supported by the historical record is consistent with the Commission’s signal that rate cases need to be filed more frequently.

For the above reasons the Commission is denying Pikeville’s request for rehearing on the rate case amortization period.

Rates Charged to Southern District

Pikeville objects to the Commission’s adjustment to the wholesale rate that Pikeville charges to Southern District. Pikeville argues that the Commission violated statutory and constitutional law when it ordered Pikeville to charge Southern District the same wholesale rate that the Commission calculated for Pikeville to charge Mountain

⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ See Case No. 2002-00022, *Proposed Adjustment of Wholesale Water Service Rates of the City of Pikeville, Kentucky* (Ky. PSC Oct. 16, 2002).

Water. Pikeville also objects to the Commission ordering Pikeville to refund to Southern District the difference from September 5, 2019, until the effective date of the rate in the Final Order, between the rate established in the Final Order (\$1.97 per 1,000 gallons) and the rate in Pikeville's tariff (\$2.25 per 1,000 gallons.)

Pikeville first argues that the issue before the Commission was solely Pikeville's wholesale water rate to Mountain Water and not the wholesale rate charges to Southern District. Pikeville asserts that at no time during this proceeding, until the December 19, 2019 Final Order, did the Commission notify Pikeville that there could be changes to Southern District's wholesale rate. Pikeville argues that the Commission's change to Southern District's wholesale rate violates KRS 278.200 (requiring a hearing before a change to water rates charged by a city), KRS 278.180 (requiring notice to a utility that it will change a rate), and KRS 278.270 (requiring a hearing and a finding that a rate is unreasonable, etc. and proscribing a rate to be followed in the future.)

Pikeville argues that the Commission failed to adhere to any of these requirements because: (1) it did not hold a hearing on the wholesale rate to be charged to Southern District; (2) it did not provide notice that it would be changing the wholesale rate to be charged to Southern District; (3) it did not find that the wholesale rate charged to Southern District was unjust, unreasonable, insufficient, unjustly discriminatory or otherwise in violation of KRS Chapter 278; and (4) it ordered Pikeville to apply the rate retroactively.

The Commission agrees with Pikeville in one regard: there should be no refund to Southern District for the difference between the rate that was on file with the Commission and the rate that the Commission ordered in the Final Order. The rate Pikeville charged to Southern District was the filed rate and could only be changed prospectively. Pikeville

should only charge Southern District the new wholesale rate for service rendered on and after December 19, 2019.

The Commission, however, disagrees that it cannot make changes to the wholesale rate that Pikeville charges to Southern District. The Commission did hold a hearing regarding Pikeville's wholesale water rate. During the hearing, Pikeville presented evidence regarding the costs incurred to provide wholesale water service, thus satisfying the hearing requirement in KRS 278.200. Pikeville may not have been on specific notice that the wholesale rate to Southern District was at issue, but the evidence presented at hearing and during the proceeding refers almost exclusively of the cost of providing wholesale water service, and not specifically to Mountain Water. Thus, it is difficult for the Commission to believe that even if Pikeville had been on notice that Southern District's wholesale rate had been at issue, the resulting wholesale rate would have been any different than that for providing the same service to Mountain Water. Furthermore, Pikeville has not provided any indication in its request for a rehearing that it could have presented evidence that Southern District's wholesale rate should be different than Mountain Water's. Pikeville's original proposed wholesale rate to charge Mountain Water was actually \$.05 more per 1,000 gallons than what it had been charging Southern District, indicating that Pikeville believed the cost of providing wholesale service to Southern District might be less than to Mountain Water. Therefore, any additional evidence taken regarding Southern District's wholesale rate, or a subsequent

investigation into Southern District's wholesale water rate, could possibly yield a lower rate than that set in the Final Order.⁵⁰

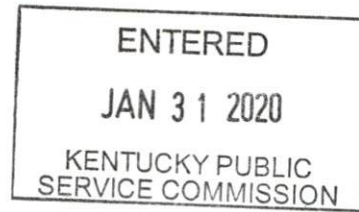
For the above reasons, the Commission finds that rehearing should be granted on the issue of refunding to Southern District any money collected before the date of the Final Order. The Commission, however, will deny rehearing on the issue of the changing of Southern District's wholesale rate.

Based on the foregoing, IT IS THEREFORE ORDERED that:

1. Pikeville's request for a hearing is granted in part and denied in part.
2. Pikeville's request to not refund any money to Southern District, as discussed herein, is granted.
3. All other Pikeville's requests for rehearing are denied.
4. This case is closed and removed from the Commission's docket.

⁵⁰ The Commission has, in the past, adjusted wholesale water rates for two utilities even though the negotiated rate was silent as to one of the utilities. See, Case No. 2005-00297 *Proposed Adjustment of Wholesale Water Service Rates of the City of Williamstown*, (Ky. PSC Nov. 30, 2005).

By the Commission



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