

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ALTERNATIVE RATE ADJUSTMENT FILING OF ) CASE NO.  
BLACK MOUNTAIN UTILITY DISTRICT ) 2015-00088

ORDER

On March 19, 2015, Black Mountain Utility District (“Black Mountain”) tendered an Application with the Commission pursuant to 807 KAR 5:076 requesting to unify the three volumetric retail water service rate structures that are currently included in its tariff<sup>1</sup> and to increase the wholesale rate charged to Hyden-Leslie Water District (“Hyden-Leslie”). In its Application, Black Mountain stated that the requested unified

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<sup>1</sup> Black Mountain is a distribution water system. It purchases wholesale water from the cities of Pineville, Harlan, and Evarts that it distributes to its customers. Black Mountain assesses Water Rate A, as shown below, to retail customers that receive wholesale water purchased from the city of Harlan. Water Rate D is assessed to retail customers who are distributed wholesale water purchased from the city of Evarts. The third rate structure is assessed to Black Mountain’s customers that were formerly served by the Green Hills Water District (“Green Hills”), which receive wholesale water purchased from the city of Pineville. Green Hills Water District was merged into Black Mountain in 2012 as approved by Commission Order dated July 13, 2012, in Case No. 2012-00095, *Application of Black Mountain Utility District and Green Hills Water District for Merger Pursuant to KRS 74.363*.

Water Rate A

First 2,000 gallons	\$21.38 Minimum Bill
Over 2,000 gallons	7.69 Per 1,000 Gallons

Water Rate D

First 2,000 gallons	\$18.13 Minimum Bill
Over 2,000 gallons	6.07 Per 1,000 Gallons

Former Green Hills Customers

First 2,000 gallons	\$23.90 Minimum Bill
Next 6,000 gallons	9.21 Per 1,000 Gallons
Over 8,000 gallons	7.65 Per 1,000 Gallons

retail rates and the requested wholesale rate would increase its annual water sales revenues by \$296,314, or 18.18 percent.<sup>2</sup>

By this Order, the Commission approves: 1) a unified volumetric retail water service rate structure that is to be applied to all retail customers; 2) a debt service surcharge that is to be assessed only to the retail customers receiving water service within the portion of Black Mountain’s service territory that existed prior to its merger with Green Hills; and 3) an increase to the wholesale rate charged to Hyden-Leslie.

The approved rates and surcharge will produce approximately \$2,012,650 in annual water sales revenues, an increase of \$389,885, or 24.03 percent, over pro forma present rate revenues in the amount of \$1,622,765. The table below shows the impact that the approved rates and surcharge will have on a typical residential customer using 4,200 gallons of water per month.

	Monthly Bill at Approved Unified Tariff	Plus: Approved Surcharge	Total Monthly Bill	Less: Monthly Bill at Current Rates	Increase / (Decrease)	Percentage Increase / (Decrease)
Water Division 1:						
Water Rate A	\$ 43.70	\$ 4.26	\$ 47.96	\$ (38.30)	\$ 9.66	25.22%
Water Rate D	43.70	4.26	47.96	(31.48)	16.48	52.35%
Water Division 2:						
Former Green Hills	43.70		43.70	(44.16)	(0.46)	-1.04%

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Increase from Requested Unified Retail Rates	\$ 291,456
Increase from Requested Wholesale Rate	<u>4,858</u>
Total Increase	<u>\$ 296,314</u>

The approved wholesale rate in the amount of \$4.60 per thousand gallons increases the current rate of \$3.71 per thousand gallons by \$.89, or 24 percent.

In its Application, Black Mountain presented financial exhibits that demonstrated that it could justify a rate adjustment that would increase annual revenues by \$548,784, or 33.08 percent; however, it requested retail rates and a wholesale rate that would generate only \$296,314 in additional revenues, an increase of 18.18 percent.

On August 5, 2015, after reviewing Black Mountain's Application and supporting documentation, Commission Staff ("Staff") issued a report ("Staff Report") containing its findings regarding Black Mountain's requested rates.<sup>3</sup> In its report, Staff found that Black Mountain's adjusted test-year operations support an annual revenue increase in the amount of \$389,885, or 24.03 percent.<sup>4</sup>

Staff further found that unification of Black Mountain's current retail rate structures will benefit all customers; is consistent with prior Commission Orders; and is, therefore, appropriate,<sup>5</sup> except that a separate surcharge should be established that is collected only from those customers that receive service within Black Mountain's service territory that existed prior to Black Mountain's merger with Green Hills.

Staff explained that the proceeds from the assessment of the debt service surcharge would be used to repay the long-term debts of Black Mountain that it had assumed prior to its merger with Green Hills. Staff noted that such a surcharge is an acceptable method to meet the requirements of the Commission's Order in Case No.

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<sup>3</sup> As noted in the November 6, 2015 letter from a Commission Staff Attorney to Jeff Derouen, Executive Director, the Staff Report at page 6 contains typographical and minor calculation errors in the Pro Forma Operating Statement, none of which impact the findings in the Staff Report.

<sup>4</sup> Staff Report at 23.

<sup>5</sup> *Id.*, Attachment A-1 at 1 and 2.

2012-00095, where the Commission found that Black Mountain must “retire bonded obligations secured by the revenue from either Green Hills District or Black Mountain District in accordance with KRS 74.363(4)”<sup>6</sup> which states, in part, that “[b]onded obligations of any district . . . secured by the revenue of the systems . . . shall continue to be retired . . . from funds collected over the same area by the new board of commissioners . . . .”

In its August 14, 2015 response to the Staff Report, Black Mountain stated that it accepted Staff’s findings and it requested that the Commission approve the rates and surcharge calculated by Staff. Black Mountain further waived its right to a hearing and requested that the matter be submitted for decision based upon the existing record.<sup>7</sup>

By Order dated September 9, 2015, the Commission required that Black Mountain provide notice to its customers of its acceptance of the rates and surcharge calculated by Staff. Black Mountain caused proper notice to be published.<sup>8</sup>

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

1. Black Mountain was organized pursuant to KRS Chapter 74. It owns and operates facilities that distribute water to approximately 3,429 customers in Harlan County, Kentucky.<sup>9</sup>

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<sup>6</sup> Case No. 2012-00095, *Application of Black Mountain Utility District and Green Hills Water District for Merger Pursuant to KRS 74.363* (Ky. PSC July 13, 2012) at 10.

<sup>7</sup> Letter from Raymond Cox, Chairman, Black Mountain Utility District, to Jeff Derouen, Executive Director, Public Service Commission (Aug. 14, 2015).

<sup>8</sup> *Id.* (Sept. 22, 2015).

<sup>9</sup> *Annual Report of Black Mountain Utility District to the Public Service Commission for the Calendar Year Ending December 31, 2013 (“Annual Report”)* at 12 and 53.

2. The calendar year ending December 31, 2013, should be used as the test year to determine the reasonableness of Black Mountain's existing and proposed rates.

3. Based upon pro forma test-year operations, Black Mountain's total pro forma present rate revenue and total pro forma operating expenses, after adjusting for known and measurable changes, are \$1,720,645 and \$1,952,609, respectively.<sup>10</sup>

4. Black Mountain currently has seven outstanding bond series that are payable to the United States Department of Agriculture Rural Development ("RD") and two outstanding loans that are payable to Kentucky Infrastructure Authority ("KIA"). The three-year average principal and interest payments for the years 2015 through 2017 is \$131,601.<sup>11</sup>

5. The Commission has historically used a Debt Service Coverage ("DSC") Method to calculate the revenue requirements of water districts with long-term debt.

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<sup>10</sup> Staff Report at 6.

Revenues and Income	
Pro Forma Present Rate Water Sales	\$ 1,614,263
Sales for Resale	8,502
Other Water Revenues	97,873
Interest Income	<u>7</u>
Total	<u>\$ 1,720,645</u>
Operating Expenses	
Operation and Maintenance Expenses	\$ 1,456,180
Depreciation Expense	492,826
Amortization Expense	868
Taxes Other Than Income	<u>2,735</u>
Total	<u>\$ 1,952,609</u>

<sup>11</sup> *Id.* at 23.

6. Black Mountain's pro forma operations, as calculated by Staff using the DSC Method, support a total revenue requirement of \$2,110,530 and an increase to water sales revenue of \$389,885, or 24.03 percent.<sup>12</sup>

7. Unification of Black Mountain's current retail rate structure will simplify its current tariff, eliminate significant administrative burdens on Black Mountain's employees, eliminate customer confusion, and allow customers to realize, in full, the economies of scale that generally accompany mergers.<sup>13</sup>

8. Black Mountain's current retail rates should be unified to the extent possible, but measures must be taken to ensure that violation of KRS 74.363(4) does not occur.

9. At the time Black Mountain merged with Green Hills, Black Mountain had seven RD bond issuances outstanding and two KIA loans outstanding. A portion of

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<sup>12</sup> *Id.*

Pro Forma Operating Expenses	\$ 1,952,609
Plus: Average Annual Principal and Interest Payments	131,601
Additional Working Capital	<u>26,320</u>
Overall Revenue Requirement	2,110,530
Less: Other Operating Income	(97,873)
Interest Income	<u>(7)</u>
Revenue Required From Rates	2,012,650
Less: Pro Forma Present Rate Service Revenues	<u>(1,622,765)</u>
Required Revenue Increase	<u>\$ 389,885</u>
Percent Increase	<u>24.03%</u>

<sup>13</sup> *Id.*, Attachment A-1 at 1.

these nine long-term debts remain outstanding. Black Mountain currently has no long-term debts outstanding that were payable by Green Hills.<sup>14</sup>

9. To ensure compliance with KRS 74.363, a debt service surcharge shall be established and collected from only those customers receiving water service within Black Mountain's service territory that existed prior its merger with Green Hills. The surcharge proceeds shall be used only for the purpose of retiring Black Mountain's long-term debts that existed at the time of merger.

10. The retail water tariff established in this proceeding shall be separated into two divisions. The Water Division 1 Tariff shall be applied to all customers receiving water service within Black Mountain's service territory that existed prior to its merger with Green Hills. This tariff shall include a volumetric rate structure and the debt service surcharge. The Water Division 2 Tariff shall be applied to customers receiving water service within Black Mountain's service territory that was formerly served by Green Hills. This tariff shall include the same volumetric rate structure as the Water Division 1 Tariff, but shall not include the debt service surcharge.

11. The water rates requested by Black Mountain would produce \$1,919,079 in annual revenues; would result in a violation of KRS 74.363; and should be denied.

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<sup>14</sup> *Id.*, Attachment A-1 at 2.

12. The water rates set forth in Appendix A will generate \$2,014,876 in annual revenues;<sup>15</sup> are fair, just, and reasonable; and should be approved for service rendered on and after the date of this Order.

13. Black Mountain presently uses service lives for ten classes of assets that are at variance with those found in a survey of the National Association of Regulatory Utility Commissioners (“NARUC”) that contained a “range of average service lives currently being used by water utilities throughout the country for water facilities designed and installed and maintained in accordance with good water works practice.”<sup>16</sup>

14. The record contains no evidence that the service lives that Black Mountain used are based upon a depreciation study or its own historic plant records.

15. Black Mountain’s assignment of service lives for these ten classes of assets is not reasonable for ratemaking purposes, and revisions in these assignments should be made for ratemaking and accounting purposes.<sup>17</sup>

16. Appendix B to this Order sets forth the classes of assets whose service lives should be adjusted, the previously assigned service life of each class, the service

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<sup>15</sup> *Id.*, Attachment A-1 at 9.

Source of Revenue	Amount
Retail Volumetric Rate	\$ 1,872,547
Debt Service Surcharge	131,787
Wholesale Rate	<u>10,542</u>
Total Revenue from Rates	<u>\$ 2,014,876</u>

<sup>16</sup> National Association of Regulatory Utility Commissioners, *Depreciation Practices for Small Water Utilities* (Aug. 15, 1979) at 10.

<sup>17</sup> Based upon these reassignments, we find that Black Mountain’s test-period depreciation expense should be reduced by \$85,833.



life range that the NARUC survey suggests for each class, and the Public Service Commission approved service life assigned for all future reporting periods.

IT IS THEREFORE ORDERED that:

1. The retail and wholesale water service rates proposed in Black Mountain's Application are denied.

2. The retail and wholesale water service rates and debt service surcharge shown in Appendix A are approved for services rendered on and after the date of this Order.

3. The proceeds from the debt service surcharge shall be used for no purpose other than the repayment of the RD bonds and KIA loans that were outstanding at the time Black Mountain merged with Green Hills. To ensure compliance with KRS 74.363(4), Black Mountain shall establish an escrow account with a financial institution into which it shall deposit the surcharge collections and out of which it shall separately account for repayment of these long-term debts. The amount of the surcharge may be reduced from time to time, with the Commission's approval, as each of the nine debt obligations is fully retired. The surcharge shall remain in effect until all debts are fully repaid.

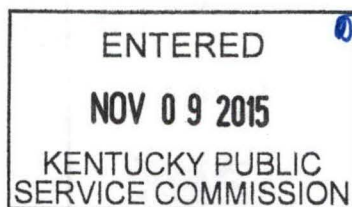
4. If at any time the cash balance of the surcharge account is not sufficient to pay a principal or interest payment, the additional cash deposit that is necessary into the surcharge account to make payment shall come from the revenues received through the assessment of the Water Division 1 volumetric water service rates.

5. Black Mountain shall include as a part of its Annual Report filed with the Commission a surcharge summary report that includes: the amount of surcharge billings and collections for each month; a list of loan payments made during the year that shows principal and interest payments separately; and copies of monthly bank statements for the surcharge account.

6. Within 20 days of the date of this Order, Black Mountain shall file revised tariff sheets with the Commission, using the Commission's electronic Tariff Filing System, containing the rates set forth in Appendix A to this Order.

7. Black Mountain shall, for accounting and ratemaking purposes, use the "PSC Approved Service Lives" set forth in Appendix B to this Order for the listed classes of assets when calculating and reporting depreciation for all reporting periods after the date of this Order. No adjustment to accumulated depreciation, or retained earnings to account for this change in accounting estimate, shall be made.

By the Commission



ATTEST:

A handwritten signature in blue ink, consisting of several loops and a long horizontal stroke at the end. It is written over a horizontal line.

Executive Director

## APPENDIX A

### APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2015-00088 DATED **NOV 09 2015**

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

#### Monthly Retail Water Rates

##### Division 1

First	2,000	gallons	\$ 25.13	Minimum bill
All Over	2,000	gallons	8.44	per 1,000 Gallons
Monthly Surcharge			\$4.26	

##### Division 2

First	2,000	gallons	\$ 25.13	Minimum bill
All Over	2,000	gallons	8.44	per 1,000 Gallons

#### Wholesale Water Rate

Wholesale Rate	\$4.60	per 1,000 Gallons
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Division 1 represents all of Black Mountain's service territory that was not acquired through its merger with Green Hills Water District.

Division 2 represents all of Black Mountain's service territory that was served by Green Hills Water District immediately prior to the merger of Green Hills Water District and Black Mountain Water District.

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
 COMMISSION IN CASE NO. 2015-00088 DATED **NOV 09 2015**

Modifications to the Service Lives  
 Of Certain Assets of Black Mountain Utility District

Asset Classification	Current	NARUC Study	Commission Approved
Pumping Equipment	15, 25	20	20
Water Treatment Eq.	50	20-35	25
Dist. Res. & Standpipes	20, 25, 50	30-60	45
Meters	25	35-45	40
Office Furniture & Eq.	5	20-25	22.5
Transportation Equipment	3, 5	7	7
Structures	15	35-40	37.5
Transmission and Distribution Mains	25	50-75	50
Meters and Installations: Installations	25	40-50	45
Telemetry	5, 15	10	10

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