

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF ELKHORN)	
WATER DISTRICT FOR A CERTIFICATE OF)	
PUBLIC CONVENIENCE AND NECESSITY TO)	
REPLACE 6600 LF OF PIPELINE, TO)	CASE NO.
REPLACE A BOOSTER PUMP STATION, TO)	2020-00113
INSTALL A NEW MASTER METER, AND NEW)	
INDIVIDUAL METERS, AND TO REFURBISH)	
AN EXISTING ELEVATED WATER TANK)	

ORDER

This matter arises from Elkhorn Water District’s (Elkhorn District) application for a Certificate of Public Convenience and Necessity (CPCN) and financing approval to replace 6,600 linear feet of pipeline, replace a booster pump station, install a new master meter, and install approximately 500 new Automated Meter Reading (AMR) customer meters. The application was accepted for filing on June 10, 2020, and there are no intervenors. The Commission extended the period to issue an order regarding the financing until November 20, 2020, pursuant to KRS 278.300(2). Elkhorn District responded to two requests for information from Commission Staff. This matter is now before the Commission for a decision on the merits.

BACKGROUND

Elkhorn District is a water district organized under KRS Chapter 74 that provides retail water service to approximately 562 customers in Franklin County.¹ Elkhorn District

¹ Application, paragraph 4.

had approximately \$339,417 in Total Operating Revenues and \$19,477 in Net Operating Income in 2019.² Elkhorn District's plant in service as of December 31, 2019, was \$1,256,605³ and its accumulated depreciation was \$1,079,556.⁴

The first project for which Elkhorn District requests a CPCN is a project to replace 6,600 linear feet of existing 3-inch asbestos/cement line with 6-inch PVC line.⁵ The existing asbestos/cement line was installed when the water district was initially constructed in or about the mid-1960s, and it has been fully depreciated.⁶ Elkhorn District indicated that the line is being replaced due to its age and because it suffers from frequent breaks, including a previous break that required a portion of the line to be taken out of service. Elkhorn District also indicated that increasing the size of the line from 3-inches to 6-inches will allow it to serve a 4-inch line on Jones Road. Currently, the line on Jones Road is served from the opposite end by a line on Switzer Road, and the new line will allow the district to continue to serve Jones Road and portions of Switzer Road in the event the line supplying the Switzer Road line fails.⁷

Although it did not quantify the effects of the pipeline replacement on operation and maintenance expenses, Elkhorn District indicated that it expects the water line replacement project will decrease its operation and maintenance costs due to a reduction

² *Annual Report of Elkhorn Water District to the Public Service Commission for the Calendar Year Ended December 31, 2019* at 20.

³ *Id.* at 27.

⁴ *Id.* at 25.

⁵ Application, paragraph 7.

⁶ Elkhorn District's Response to Commission Staff's First Request for Information (Response to Staff's First Request) (filed July 23, 2020), Item 9(a), (b).

⁷ *Id.*, Item 9(c).

in repairs.⁸ Further, Elkhorn District indicated that by creating a loop connecting a line to Jones Road, Elkhorn District will be able to eliminate a dead end on Jones Road that currently requires constant flushing at a cost of approximately \$14,454 annually.⁹

The second project for which Elkhorn District requests a CPCN is a project to construct a new 400 GPM booster pump station to replace an existing station. Elkhorn District described the project by stating that:

The new Booster pump System (BPS) will be constructed across Elkhorn Creek from the current station. The new BPS will will [sic] be a 2 story structure with pumps and controls on the 2nd floor. It will be a block structure elevated above the 500 year flood level. An internal stairway will allow access to the pumping floor. The pumps will be variable speed drives, built on a skid and delivered and installed as a unit. New internal valves and piping will be required to put the new BPS on line.¹⁰

Elkhorn District indicated that the primary purpose of constructing a new pump station to replace the current pump station was to avoid future issues with flooding. Elkhorn District indicated that the existing pump station has flooded eight times in the last 25 years. It further noted that two of the floods submerged the pumps, motors and controls, and required replacement of the motors and the controls.¹¹ Elkhorn District indicated that construction of the new pump station would move it out of the flood plain.¹² Elkhorn District further argued that the age of the current pump station supported the

⁸ *Id.*, Item 9(f).

⁹ *Id.*, Item 9(e).

¹⁰ *Id.*, Item 11(a).

¹¹ *Id.*, Item 11(b).

¹² *Id.*, Item 11(d).

need for replacement stating that the pump station was constructed 50 years ago, the current pumps are 40 years old, and the controls are 20 years old. In addition, Elkhorn District indicated that the electrical system is original and outdated.¹³

The third project for which Elkhorn District requests a CPCN is a project to replace its existing customer meters with approximately 500 new radio read meters and remote reading equipment. Elkhorn District stated that the existing meters were not accurately reading and needed replacement and the existing meters have reached the end or are reaching the end of their useful lives and are fully depreciated.¹⁴ Elkhorn District further indicated that it chose AMR meters as opposed to manual read or Advanced Metering Infrastructure (AMI) meters because they are compatible with the billing system used by Peaks Mill Water District, which has contracted to perform billing on behalf of Elkhorn District.¹⁵ Elkhorn District also indicated that the AMR system would eliminate transcription errors and would reduce the time necessary to check meters by about 66 percent.¹⁶ Elkhorn District indicated that it chose Sensus SR meters, as distinguished from another brand or model, because its other meters are Sensus SR meters and it wanted to use the same meters throughout its service area.¹⁷

The fourth project for which Elkhorn District requests a CPCN is a project to install a new larger master meter at the point where it takes delivery of its water from the

¹³ *Id.*, Item 11(c).

¹⁴ *Id.*, Item 10(b), (c).

¹⁵ Elkhorn District's response to Commission Staff's Second Request for Information (Response to Staff's Second Request) (filed Oct. 15, 2020), Item 2(b).

¹⁶ Response to Staff's First Request (filed July 23, 2020), Item 10(c), (g), and Item 3.

¹⁷ Response to Staff's Second Request (filed Oct. 15, 2020), Item 2(c).

Frankfort Electric and Water Plant Board (Franklin Plant Board). For the new master meter, Elkhorn District explained that the existing pit would be used but that two 4 x 3 reducers would need to be removed, a straight pipe would be flanged to the inlet valve, a 4-inch brass in line strainer would be installed, and a 4-inch Sensus auto-read turbine meter would be installed.¹⁸

Elkhorn District indicated that the new master meter was being installed to increase its flow from the Franklin Plant Board. Elkhorn District indicated that the new pumping station, discussed above, will require the full capacity of the current 3-inch master meter to operate properly but that there are a number of customers between the master meter and the proposed location for the pump station such that the larger master meter is necessary to serve those customers and provide capacity to the pumping station.¹⁹

Elkhorn District sent requests for proposals for the first three projects for which it is requesting a CPCN to a number of contractor and engineering firms to obtain competitive bids. Elkhorn District received several bids for each project and intends to accept the lowest bids.²⁰ Based on the bids received, the total estimated cost for the new line project and pump station project, which were bid together, is \$496,067, with the costs broken down as follows:²¹

Engineering Costs	\$ 38,254
Construction Costs ²²	\$399,950
Construction Administration	\$ 5,738

¹⁸ Response to Staff's First Request (filed July 23, 2020), Item 12.

¹⁹ *Id.*

²⁰ Response to Staff's Second Request (filed Oct. 15, 2020), Item 1.

²¹ Response to Staff's First Request (filed July 23, 2020), Item 1, 2.

²² Application, Tab 14.

Construction Inspection	\$ 27,125
Cost of Real Property	<u>\$ 25,000</u>
Total Project Cost	\$496,067

The total estimated cost of the new customer meter project, which was bid separately, is \$230,448, with the costs broken down as follows:²³

Engineering Costs	\$ 18,842
Construction Costs	\$195,420
Construction Administration	\$ 2,826
Construction Inspection	<u>\$ 13,360</u>
Total Project Cost	\$230,448

The new line, pump station, and new customer meter projects will be funded by a loan from the Kentucky Infrastructure Authority (KIA) not to exceed \$750,000.²⁴ The proposed loan will bear interest at a rate of 2.75 percent per annum. Interest on the proposed loan will accrue from the time that Elkhorn District begins drawing funds from KIA, but principal payment obligations will not accrue until the projects that the loan will fund are placed in service. Further, the loan must be repaid over a period not to exceed 20 years from the date on which the projects begin operations. The proposed loan will be secured by a pledge of Elkhorn District's revenues.²⁵

Work on the master meter project will be performed by personnel from Frankfort Plant Board and Elkhorn District.²⁶ The Frankfort Plant Board will install the new master meter itself and Elkhorn District will do the work on the pipes in and around the pit to

²³ Response to Staff's First Request (filed July 23, 2020), Item 1, 2.

²⁴ Application, paragraph 20, and Exhibit 7.

²⁵ *Id.*, paragraph 20, and Exhibit 9 and Exhibit 11.

²⁶ Response to Staff's Second Request (filed Oct. 15, 2020), Item 4.

accommodate the larger master meter.²⁷ Elkhorn District will fund the master meter project with existing funds.²⁸

An engineering report prepared as part of KIA's review estimated that the annual debt service on the KIA loans would be \$49,254 per year and that depreciation on the projects would be \$14,707 per year, based on a useful life of 50 years. To meet its debt service obligations, the engineering report indicated that it would be necessary for Elkhorn District to raise its current rates by about 10 percent.²⁹ Elkhorn District indicated that a request for a rate increase would be filed as part of a separate application to the Commission during the construction phase of the projects but that it did not expect that the full 10 percent increase proposed in the engineering report would be necessary.³⁰

DISCUSSION

Elkhorn District's Request for a CPCN

The Commission's standard of review regarding a CPCN is well settled. Under KRS 278.020(1), no utility may construct or acquire any facility to be used in providing utility service to the public until it has obtained a CPCN from this Commission. To obtain a CPCN, the utility must demonstrate a need for such facilities and an absence of wasteful duplication.³¹

"Need" requires:

²⁷ Response to Staff's First Request (filed July 23, 2020), Item 12; Response to Staff's Second Request (filed Oct. 15, 2020), Items 1, 2.

²⁸ Response to Staff's Second Request (filed Oct. 15, 2020), Item 5.

²⁹ Application at Exhibit 7.

³⁰ Response to Staff's First Request (filed July 23, 2020), Item 15.

³¹ *Kentucky Utilities Co. v. Pub. Serv. Comm'n*, 252 S.W.2d 885 (Ky. 1952).

[A] showing of a substantial inadequacy of existing service, involving a consumer market sufficiently large to make it economically feasible for the new system or facility to be constructed or operated.

[T]he inadequacy must be due either to a substantial deficiency of service facilities, beyond what could be supplied by normal improvements in the ordinary course of business; or to indifference, poor management or disregard of the rights of consumers, persisting over such a period of time as to establish an inability or unwillingness to render adequate service.³²

“Wasteful duplication” is defined as “an excess of capacity over need” and “an excessive investment in relation to productivity or efficiency, and an unnecessary multiplicity of physical properties.”³³ To demonstrate that a proposed facility does not result in wasteful duplication, we have held that the applicant must demonstrate that a thorough review of all reasonable alternatives has been performed.³⁴ Selection of a proposal that ultimately costs more than an alternative does not necessarily result in wasteful duplication.³⁵ All relevant factors must be balanced.³⁶ The statutory touchstone for ratemaking in Kentucky is the requirement that rates set by the Commission must be fair, just, and reasonable.³⁷

³² *Id.* at 890.

³³ *Id.*

³⁴ Case No. 2005-00142, *Joint Application of Louisville Gas and Electric Company and Kentucky Utilities Company for the Construction of Transmission Facilities in Jefferson, Bullitt, Meade, and Hardin Counties, Kentucky* (Ky. PSC Sept. 8, 2005).

³⁵ See *Kentucky Utilities Co. v. Pub. Serv. Comm’n*, 390 S.W.2d 168, 175 (Ky. 1965). See also Case No. 2005-00089, *Application of East Kentucky Power Cooperative, Inc. for a Certificate of Public Convenience and Necessity for the Construction of a 138 kV Electric Transmission Line in Rowan County, Kentucky* (Ky. PSC Aug. 19, 2005).

³⁶ Case No. 2005-00089, *East Kentucky Power Cooperative, Inc.* (Ky. PSC Aug. 19, 2005), final Order at 6.

³⁷ KRS 278.190(3).

Here, Elkhorn District established that the four projects for which it requests a CPCN are necessary. As noted above, the new line proposed by Elkhorn District will replace an existing line that has reach the end of its useful life, is fully depreciated, suffers failures that result in service interruptions, and is partially unusable such that Elkhorn District has to engage in constant flushing. The new booster pump station will replace an existing flood prone station, and the new master meter is necessary to provide sufficient capacity to the new pump station. The new customer meters will replace existing customer meters that are fully depreciated and are reaching the end of their useful lives. Thus, the Commission finds that the projects will address needs that justify granting a CPCN for the projects.

Elkhorn District also established that the projects will not result in wasteful duplication. First, as noted above, the projects are intended to replace existing systems that are in need of replacement. Second, with the exception of the master meter project, which is being completed with existing funds and, in large part, by Elkhorn District's wholesale provider, the projects were competitively bid and Elkhorn District indicated that it accepted to the lowest bid for each project. Further, while Elkhorn District did increase the capacity or capabilities of some of the systems being replaced, the Commission finds that Elkhorn District's decisions in that regard were reasonable under the circumstances.³⁸ Thus, the Commission finds that the projects for which Elkhorn District

³⁸ For instance, the Commission observes that Elkhorn District is replacing a 3-inch line with a 6-inch line, which will incrementally increase the cost of the line. However, Elkhorn District indicated that doing so would create a redundancy that would allow it to serve Jones Road and portions of Switzer Road even if another line that supplies water to Switzer Road failed. The Commission finds that it is reasonable to install the larger line under the circumstances, since the bulk of the costs associated with the project would not be changed by increasing the size of the line and it will provide additional capacity.

is requesting a CPCN will not result in wasteful duplication and that Elkhorn District's request for a CPCN for those projects should be granted.

Elkhorn District's Request for Financing Approval

KRS 278.300(1) provides that "[n]o utility shall issue any securities or evidences of indebtedness . . . until it has been authorized so to do by order of the commission." The Commission is prohibited from approving the issue of securities or evidences of indebtedness unless it finds that the issue "is necessary or appropriate for or consistent with the proper performance by the utility of its service to the public and will not impair its ability to perform that service, and is reasonably necessary and appropriate for such purpose."³⁹ The Commission may grant approval for the issuance of securities or evidences of indebtedness "with such modifications and upon such terms and conditions as [it] deems necessary and appropriate."⁴⁰

Here, Elkhorn District requests authority to obtain a loan from KIA in an amount not to exceed \$750,000 with an interest rate of 2.75 percent per annum for the purpose of funding the line replacement project, the new pump station project, and the new customer meters project. As noted above, the Commission finds that those projects are necessary and will not result in wasteful duplication. Thus, subject to the conditions discussed below, the Commission finds that the loan for which Elkhorn District requests

Similarly, Elkhorn District is replacing manual read meters with AMR meters. Elkhorn District indicated that the AMR meters would reduce the time spent reading meters by about 60 percent each month. Elkhorn District also indicated that it chose AMR meters as opposed to standard meters or AMI meters, because the AMR meters are compatible with the software used by Peaks Mill Water District, which currently does Elkhorn District's billing. The Commission finds that Elkhorn District's reasons for choosing the meters are reasonable under the circumstances and given its size.

³⁹ KRS 278.300(3).

⁴⁰ KRS 278.300(4).

approval is for a lawful object within the corporate purposes of Elkhorn District’s utility operations, is necessary and appropriate for and consistent with the proper performance of Elkhorn District’s service to the public, will not impair Elkhorn District’s ability to perform that service, and is reasonably necessary and appropriate for such purposes.

However, as KIA recognized and Elkhorn District acknowledged in its application, Elkhorn District will need to raise its current rates to meet its operating expenses and debt service if it accepts the KIA loan. Elkhorn District’s engineer estimated that the debt service on the KIA loan would be \$49,254.00 per year, but Elkhorn District’s net operating income in 2019 was \$19,477, which would be insufficient to cover the debt service. Further, Elkhorn District’s financial performance in some previous years was worse than it was in 2019,⁴¹ and Elkhorn District’s Annual Reports and Audits show that from 2017 through 2019 Elkhorn District’s accumulated cash working capital was \$5,417, which indicates Elkhorn District is unable to accumulate adequate cash reserves to cover emergency repairs or expenses even before incurring the debt service obligations from the KIA loan.⁴² Finally, as a condition for providing the loan, KIA indicated that it would

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Year	2015	2016	2017	2018	2019
Net Income	\$ (28,571)	\$ (8,363)	\$ (9,948)	\$ (58,152)	\$ 13,430
Less: Principal Payments	(9,300)	(5,100)	(5,500)	(5,900)	(6,300)
Add: Depreciation Expense	28,916	28,087	27,804	25,416	18,898
Cash Basis Income	<u>\$ (8,955)</u>	<u>\$ 14,624</u>	<u>\$ 12,356</u>	<u>\$ (38,636)</u>	<u>\$ 26,028</u>
Year	2015	2016	2017	2018	2019
Cash and Cash Equivalents		\$ 195,710	\$ 190,096	\$ 166,981	\$ 184,395
Net Increase (Decrease) in Cash		20,976	(5,614)	(23,115)	17,414

Elkhorn District’s Audit Reports for calendar years 2015 and 2016 have not been filled with the Commission. Further, the Commission notes that Net Income in the table is distinct from Net Operating Income described in the text of the order, because it includes non-operating revenue and interest expense not included in Net Operating Income.

⁴² \$(8,955) (2015 Cash Working Capital) + \$14,624 (2016 Cash Working Capital) + \$12,356 (2017 Cash Working Capital) + \$(38,636) (2018 Cash Working Capital) + \$26,028 (2019 Cash Working Capital) = \$5,417.

require Elkhorn District to raise its rates, subject to Commission approval, to cover its debt service obligations. Thus, as a condition for the approval of the KIA loan, the Commission finds Elkhorn District must file an application for a rate adjustment pursuant to 807 KAR 5:001, Section 16, or 807 KAR 5:076 within 60 days of drawing any portion of the KIA loan to ensure it is able to meet its financial obligations.

IT IS THEREFORE ORDERED that:

1. Elkhorn District is granted a CPCN to replace 6,600 linear feet of pipeline, replace a booster pump station, install a new master meter, and install approximately 500 new AMR customer meters as set forth in its application.

2. Elkhorn District shall immediately notify the Commission upon knowledge of any material changes to the projects, including, but not limited to, increase in costs and any significant delays in construction.

3. Any material deviation from the construction approved by this Order shall be undertaken only with the prior approval of the Commission.

4. Elkhorn District shall file with the Commission documentation of the total costs of the projects, including the cost of construction and all other capitalized costs, (e.g., engineering, legal, administrative, etc.) within 60 days of the date that construction authorized under this CPCN is substantially completed. Construction costs shall be classified into appropriate plant accounts in accordance with the Uniform System of Accounts for water utilities prescribed by the Commission.

5. Elkhorn District shall file a copy of the “as-built” drawings and a certified statement that the construction has been satisfactorily completed in accordance with the

contract plans and specifications within 60 days of the substantial completion of the construction certificated herein.

6. Elkhorn District is authorized to issue the evidences of debt in a principal amount not to exceed \$750,000 subject to the conditions discussed herein.

7. The proceeds from the issue of the evidences of debt authorized shall be used only for the lawful purposes set out in the application.

8. Elkhorn District shall only execute the KIA loan documents to the extent their terms and conditions are consistent with the loan described in its application, except as otherwise authorized herein.

9. Elkhorn District shall file the loan documents in this matter within ten days of the executing them.

10. Any documents filed in the future pursuant to ordering paragraphs 4, 5, and 9 shall reference this case number and shall be retained in the post-case correspondence file.

11. Elkhorn District must file an application for a rate adjustment pursuant to the procedures set forth in 807 KAR 5:001, Section 16 or 807 KAR 5:076 within 60 days of drawing any portion of the KIA loan.

12. The Executive Director is delegated authority to grant reasonable extensions of time for filing any documents required by this Order upon Elkhorn District's showing of good cause for such extension.

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

Nothing contained herein shall be deemed a warranty or finding of value of securities or financing authorized herein on the part of the Commonwealth of Kentucky or any agency thereof.

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By the Commission

ENTERED
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KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:



Deputy Executive Director

Case No. 2020-00113

*Clayton B. Patrick
Attorney
Patrick Law Firm
415 W. Main Street
Suite 8
Frankfort, KENTUCKY 40601

*Elkhorn Water District
7165 US 127 North
P. O. Box 67
Frankfort, KY 40602

*Michael Dudgeon
Chairman
Elkhorn Water District
P. O. Box 67
Frankfort, KY 40602