

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC INVESTIGATION INTO TRANSFER	)	
OF OWNERSHIP TO PRESTONSBURG CITY	)	
UTILITIES COMMISSION OF THE	)	CASE NO.
WASTEWATER SYSTEM AND CERTAIN	)	2020-00228
PORTIONS OF THE WATER SYSTEM OF	)	
SOUTHERN WATER AND SEWER DISTRICT	)	
PURSUANT TO KRS 278.250 AND KRS 278.390	)	

ORDER

On July 20, 2020, the Commission initiated this investigation into the transfer of wastewater system and portions of the water system assets belonging to Southern Water and Sewer District (Southern District) to the Prestonsburg City Utilities Commission (PCUC), pursuant to KRS 278.250 and KRS 278.390.<sup>1</sup> The parties filed responses to Commission Orders, including an executed amended asset purchase agreement (First Amended Asset Purchase Agreement), the financial management services contract (Financial Management Services Contract), and supporting documents. A formal hearing was held on September 1, 2020. The parties responded to a post-hearing request for information, which included the Second Amendment to the Asset Purchase Agreement (Second Amended Asset Purchase Agreement) and First Amendment to the Financial Management Services Contract (First Amended Financial Management Services

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<sup>1</sup> KRS 278.250 authorizes the Commission to investigate the condition of any utility subject to its jurisdiction. KRS 278.390 provides that Commission Orders are in effect until, among other things, they are revoked or modified.

Contract) that amended previous agreements to address issues raised at the hearing. This matter now stands submitted for a decision.<sup>2</sup>

### BACKGROUND

In Case No. 2017-00044, the Commission approved the transfer of certain wastewater and water system assets from Southern District to PCUC.<sup>3</sup> Subsequently, the transfer of the wastewater system closed, but the transfer of the water system assets never closed because the United States Department of Agriculture Rural Development Agency (RD), had not approved the transfer. RD withheld approval of the transfer, requiring an appraisal to be conducted and accepted before RD would release its lien on water assets transferred to PCUC. The parties obtained an appraisal that valued the transaction at \$4,100,000, but RD did not accept the reliability of the valuation, which appeared to be unduly excessive. Although the transaction did not close, PCUC obtained beneficial ownership of the assets and operated a portion of Southern District's water system since July 1, 2017. In addition to operating the portion of the water system, PCUC conducted routine maintenance of the system and replaced all water meters.<sup>4</sup>

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<sup>2</sup> Response of PCUC to the Commissions' Order dated September 2, 2020 (filed Sept. 11, 2020), Exhibits A and B; and Response of Southern District to Commission's Order Dated September 2, 2020 (filed Sept. 16, 2020), attachments.

<sup>3</sup> Case No. 2017-00044, *Electronic Joint Application of Southern Water and Sewer District; Prestonsburg City's Utility Commission; and the City of Prestonsburg for an Order Approving the Transfer of Ownership of the Wastewater System and Certain Portions of the Water System of Southern Water and Sewer District* (Ky. PSC May 2, 2017).

<sup>4</sup> Response of PCUC to the Commission's Order Dated July 20, 2020 (PCUC Response to July 20, 2020 Order) (filed July 30, 2020) at 2-4.

In subsequent proceedings, Southern District stated that PCUC was operating the wastewater system pursuant to an operating and maintenance agreement and that Southern District collected, but had not remitted, sewer fees due to PCUC.<sup>5</sup>

In June 2020, the parties obtained a new appraisal that valued the water system assets at issue at \$1,510,960.<sup>6</sup> RD approved the transaction on August 10, 2020.<sup>7</sup> The parties executed the First Amended Asset Purchase Agreement to amend the initial asset purchase agreement (Asset Purchase Agreement) to reflect certain new terms.<sup>8</sup> The parties also executed the Financial Management Services Contract to memorialize the negotiated terms for Southern District's collection of fees for sewer service from its customers in Wayland and Eastern areas, who receive water from Southern District and sewer service from PCUC, and remittal to PCUC.<sup>9</sup> In response to issues raised at the September 1, 2020 hearing, Southern District and PCUC executed the Second Amended Asset Purchase Agreement<sup>10</sup> and the First Amended Financial Management Services Contract,<sup>11</sup> as discussed below.

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<sup>5</sup> Case No. 2019-00131, *Application of Southern Water and Sewer District for an Alternative Rate Adjustment* (Ky. PSC May 8, 2019), Notice of Filing Southern District's General Ledger; and Case No. 2019-00041, *Electronic Investigation into Excessive Water Loss by Kentucky's Jurisdictional Water Utilities* (Ky. PSC Oct. 7, 2019), July 16, 2019 Transcript at 42, lines 18–23.

<sup>6</sup> PCUC Response to July 20, 2020 Order at 4.

<sup>7</sup> First Supplemental Response of PCUC to the Commission's Order Dated July 20, 2020 (filed Aug. 13, 2020) at Exhibit C (RD Approval Letter).

<sup>8</sup> *Id.* at Exhibit A (First Amended Asset Purchase Agreement).

<sup>9</sup> *Id.* at Exhibit B (Financial Management Services Contract).

<sup>10</sup> Response of PCUC to the Commission's Order Dated September 2, 2020 (filed Sept. 11, 2020) at Exhibit A (Second Amended Asset Purchase Agreement).

<sup>11</sup> *Id.* at Exhibit B (First Amended Financial Management Service Contract).

## TRANSACTION

### Asset Purchase Agreement

Relevant to this proceeding, the Asset Purchase Agreement provided that PCUC and the city of Prestonsburg (Prestonsburg)<sup>12</sup> would pay Southern District \$2,140,000 to acquire a portion of Southern District's water system located along Kentucky Route 850 (Pyramid Area) and along U.S. Highway 23 (Stanville/Betsy Layne/Harold Area), and Southern District's wastewater system in its entirety.<sup>13</sup> In addition to the \$2,140,000 payment, PCUC and Prestonsburg would either assume or pay in full the debt obligations of Southern District to the Kentucky Infrastructure Authority (KIA) and RD.<sup>14</sup> PCUC and Prestonsburg further agreed that PCUC would charge Southern District's then-current rates for water service to customers in the Pyramid Area and the Stanville/Betsy Layne/Harold Area, and not raise rates for at least three years following the closing of the transaction.

### First Amended Asset Purchase Agreement

The First Amended Asset Purchase Agreement was executed on July 27, 2020, by Southern District and PCUC.<sup>15</sup> Under the terms of the First Amended Asset Purchase Agreement, PCUC would pay \$1,600,000 to RD for the release of RD's lien in order to acquire the Stanville/Betsy Layne/Harold Area water system infrastructure only.<sup>16</sup>

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<sup>12</sup> Prestonsburg was a party to the Asset Purchase Agreement because it has sole authority to issue or assume debt on behalf of PCUC.

<sup>13</sup> Sept. 1, 2020 Hearing, PSC Staff Exhibit 2, Asset Purchase Agreement, paragraphs 2, 3, 4, and 9. (Asset Purchase Agreement).

<sup>14</sup> *Id.* at paragraph 4.

<sup>15</sup> There is a signature line for RD, which declined to sign the agreement because it did not negotiate the terms. Sept. 1, 2020 Hearing Video Transcript (HVT) at 9:28:24.

<sup>16</sup> First Amended Asset Purchase Agreement at 3, paragraph 1.

Although PCUC had operated and maintained the Pyramid Area water system assets since 2017, PCUC released its claim on the Pyramid Area, with Southern District retaining legal ownership of these assets.<sup>17</sup> Additionally, Southern District acknowledged that it owed PCUC \$275,000 in unremitted sewer fees of which PCUC agreed to forgive \$137,500 of that debt, with Southern District paying the remaining \$137,500 in monthly payments of \$2,500.<sup>18</sup>

### Second Amended Asset Purchase Agreement

At the September 1, 2020 hearing, the Commissioners raised concerns that the term “Designated Water Assets” as used in the First Amended Asset Purchase Agreement was not defined with sufficient specificity to avoid future contract interpretation issues. The Commissioners raised additional concerns that Prestonsburg was not a signatory to the Amended Asset Purchase Agreement. Finally, the Commissioners were concerned about the equity of the contract term in the Asset Purchase Agreement that PCUC would charge customers in the Stanville/Betsy and Layne/Harold Area the rate for three years after the transaction closed. Given that the transaction had not closed, strict compliance with these terms would mean that customers in the Stanville/Betsy and Layne/Harold Area would be charged lesser rates for over six years, from 2017 to 2023.

In response, the parties executed the Second Amended Asset Purchase Agreement, which addressed all of the above concerns. The term “Designated Water Assets” was defined as the Pyramid, and Stanville/Betsy Layne/Harold portions of the

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<sup>17</sup> *Id.*, at 4–5, paragraph 6.

<sup>18</sup> *Id.*, at 4, paragraph 4.

water system assets.<sup>19</sup> Prestonsburg, a signatory to the Second Amended Asset Purchase Agreement, ratified the terms of the First Amended Asset Purchase Agreement.<sup>20</sup> Southern District and PCUC acknowledged that PCUC had charged customers in the Pyramid and Stanville/Betsy Layne/Harold Areas the rate as set forth in the Asset Purchase Agreement in excess of three years, and that the customers in the Stanville/Betsy Layne/Harold Areas would now be charged the same rate as other PCUC customers who live outside the city limits of Prestonsburg.<sup>21</sup>

### Financial Management Agreement

The Financial Management Services Agreement established the terms for Southern District's collection and remittance of sewer fees to PCUC for customers who receive water service from Southern District but sewer service from PCUC in the Eastern and Wayland Area. As set forth in the Financial Management Service Agreement, PCUC authorized Southern District to collect PCUC's sewer fees in areas where Southern District provided water service, remitted amounts collected during the previous month by the tenth day of the succeeding month, with Southern District receiving an administrative fee of three percent of PCUC's tariff rate for each customer billed.<sup>22</sup> Partial payments received from a customer would be applied first to the amount due to Southern District for water service, with the remainder applied to the amount due to PCUC for sewer

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<sup>19</sup> Second Amended Asset Purchase Agreement at 2. The Stanville/Betsy Layne/Harold Area had been part of the Sandy Valley distribution system before being merged into Southern District. For the purposes of the Second Amended Asset Purchase Agreement, "Designated Water Assets" are the assets in the Pyramid Area and Sandy Valley area.

<sup>20</sup> Second Amended Asset Purchase Agreement at 3, paragraph 1.

<sup>21</sup> *Id.* at 3, paragraph 2.

<sup>22</sup> Financial Management Services Agreement at 3, paragraph 9 and 10.

service, and provided for termination of a customer's water service for nonpayment of the sewer bill.<sup>23</sup>

#### First Amended Financial Management Agreement

At the September 1, 2020 hearing, the Commissioners raised concerns regarding the terms for disconnection of water service for non-payment of sewer service fees and the accounting for partial payments. In response, the parties executed the First Amended Financial Management Agreement, which addressed these concerns.

Pursuant to the First Amended Financial Management Agreement, partial payments are first applied to any amount due to PCUC for sewer service, with any remainder applied to the amount due to Southern District for water service. Further, any disconnection of water service for nonpayment of sewer fees would be made subject to KRS 96.934, which provides for termination of water service for nonpayment of the customer's sewer bill, and subject to applicable Commission regulations, including notice requirements.<sup>24</sup>

#### DISCUSSION AND FINDINGS

As Southern District and PCUC stated, the proposed transfer of assets makes the best of an unfortunate situation that was created by the then-board of Southern District and the then-superintendent of PCUC.<sup>25</sup> PCUC previously paid \$2,140,000 to Southern District, paid for improvements to the Pyramid Area and Stanville/Betsy Layne/Harold Area water assets, and now will pay \$1,600,000 to RD for the Stanville/Betsy

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<sup>23</sup> *Id.* at 2, paragraph 6.

<sup>24</sup> First Amended Financial Management Services Contract at unnumbered page 1 and at 2, paragraph 6.

<sup>25</sup> Sept. 1, 2020 HVT at 10:07:55 and 11:24:57.

Layne/Harold Area water assets, and forgive \$137,500 of Southern District's debt to Prestonsburg.<sup>26</sup> Further, Prestonsburg paid \$158,000 to Floyd County Fiscal Court as part of the initial Asset Purchase Agreement.<sup>27</sup> If the Commission denied the proposed amended asset transfer and required the parties to unwind the transaction, Southern District would be unable to reimburse Prestonsburg for the \$2,140,000 previously expended or reimburse Prestonsburg for the monies expended to upgrade the Pyramid Area and Stanville/Betsy Layne/Harold Area assets. Additionally, Southern District is financially and operationally unable to resume ownership and control of the wastewater assets.

Based upon a review of the evidence of record, the Commission finds that the proposed asset transfer, as amended in the First and Second Amended Asset Purchase Agreements, is reasonable and is in the public interest. This is because Southern District receives a significant financial benefit in the form of \$1,600,000 paid to RD and forgiveness of \$137,500 of unpaid debt to PCUC, as well as much-needed additional revenues from resuming service to customers in the Pyramid Area. Further, Southern District customers who receive sewer service from PCUC will continue to receive a necessary service from a competent sewer utility. Based on the above, the Commission concludes that the First and Second Amended Asset Purchase Agreements should be approved.

The Commission further finds that the Financial Management Services Contract and First Amended Financial Management Services Contract are reasonable. Southern

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<sup>26</sup> *Id.* at 11:23:26.

<sup>27</sup> *Id.* at 11:24:48.



District's rights and responsibilities in collecting and remitting sewer fees are clearly delineated in the contract, as amended. PCUC's interest in receiving timely payments and enforcing its right to payment for use of the sewer are appropriately protected in the contract, as amended. Based on the above, the Commission concludes that the Financial Management Services Contract and First Amended Financial Management Services Contract should be approved.

IT IS THEREFORE ORDERED that:

1. The proposed amended transfer of ownership and control of Southern District Water Service assets as set forth in the First Amended Asset Purchase Agreement and Second Amended Asset Purchase Agreement is approved.
2. The proposed Financial Management Services Agreement and Amended Financial Management Services Agreement is approved.
3. Within ten days of the transfer of the Stanville/Betsy Layne/Harold Area assets, Southern District and PCUC shall notify the Commission in writing of the transfer's occurrence.
4. Any material revision to the proposed transaction must be approved by the Commission in order for the amendment to be effective.
5. Any document filed pursuant to ordering paragraphs 3 and 4 shall reference this case number and shall be retained in the post-case correspondence file.
6. This case is closed and removed from the Commission's docket.

By the Commission

ENTERED  
SEP 28 2020 rcs  
KENTUCKY PUBLIC  
SERVICE COMMISSION

ATTEST:

  
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Case No. 2020-00228

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