

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC TARIFF FILING OF MOREHEAD)	
UTILITY PLANT BOARD TO REVISE ITS)	
WHOLESALE WATER RATES TO AND ENTER)	CASE NO.
INTO REVISED WATER PURCHASE)	2024-00193
AGREEMENTS WITH BATH COUNTY WATER)	
DISTRICT AND ROWAN WATER, INC.)	

ORDER

On April 4, 2024, the Morehead Utility Plant Board (Morehead), a municipality, filed a tariff with the Commission to increase its wholesale water rates to Bath County Water District (Bath District), a water district organized pursuant to KRS Chapter 74, and Rowan Water Inc. (Rowan Water), a water association organized pursuant to KRS chapter 273, with an effective date July 1, 2024. Subsequently, on May 17, 2024, Morehead filed revised Water Purchase Agreements (Revised Agreements) with Bath District and Rowan Water that contained an effective date of the later of July 1, 2024, or the date the Revised Agreements were deemed filed by the Commission.

By Order¹ dated June 28, 2024, the Commission approved Morehead's proposed Phase 1 rates of \$2.284 per 1,000 gallons for service rendered on and after July 1, 2024; however, the Order suspended the Revised Agreements for one day until July 2, 2024, and opened an investigation into the Revised Agreements to determine the reasonableness of the terms and rates. Commission Staff issued two requests for

¹ Order (Ky. PSC June 28, 2024) at 6.

information to Morehead.² There are no intervenors in this matter. On October 10, 2024, Morehead filed a request to submit the matter on the record. The case now stands submitted for a decision.

LEGAL STANDARD

Pursuant to KRS 278.200, the Commission has jurisdiction over Morehead's rates for wholesale water service to Bath District and Rowan Water. The Supreme Court's decision in *Simpson County Water District v. City of Franklin* 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

Morehead's wholesale water rates charged to Bath District and Rowan Water are subject to KRS 278.030, which provides that a utility may collect fair, just and reasonable rates. KRS 278.260 explains that the Commission may, on its own motion, investigate

² Morehead's Response to Commission Staff's First Request for Information (Staff's First Request) (filed July 31, 2024); Morehead's Response to Commission Staff's Second Request for Information (Staff's Second Request) (filed Aug. 23, 2024).

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

⁴ *Simpson County Water District v. City of Franklin*, 872 S.W.2d 460, 463 (Ky. 1994); *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, 2016).

whether “any regulation, measurement, practice or act affecting or relating to the service of the utility or any service in connection therewith is unreasonable.” Thus, in accordance with KRS 278.030, KRS 278.200, and KRS 278.260, the Commission must determine whether the provisions of the Revised Agreements filed by Morehead regarding future rate revisions to Bath District and Rowan Water are fair, just and reasonable.

REVISED AGREEMENTS

The Revised Agreements have an initial term of 45 years⁵ and set an initial wholesale rate of \$2.284 per 1,000 gallons⁶ effective July 1, 2024. As noted above, the Commission approved this rate effective July 1, 2024. The Revised Agreements go on to set a wholesale rate of \$3.61 per 1,000 gallons effective July 1, 2025, for Bath District⁷ and July 15, 2025, for Rowan Water⁸. The rate study provided by Morehead supported a Phase 2 rate of \$4.74 per 1,000 gallons.⁹ Morehead updated this amount due to grant funding that has been awarded since their initial filing.¹⁰ Based upon the additional grant funding received, Morehead’s wholesale rate computation supports a rate of \$4.001 per 1,000 gallons for Phase 2.¹¹ The parties agreed to the \$3.61 per 1,000 gallons rate with the understanding that the actual costs were greater, and Morehead may recapture the

⁵ Water Purchase Agreement between Morehead Utility Plant Board and Bath District (filed June 14, 2024) at 2; Water Purchase Agreement between Morehead Utility Plant Board and Rowan Water (filed June 14, 2024) at 2.

⁶ Water Purchase Agreement between Morehead Utility Plant Board and Bath District at 6; Water Purchase Agreement between Morehead Utility Plant Board and Rowan Water at 7.

⁷ Water Purchase Agreement between Morehead Utility Plant Board and Bath District at 6.

⁸ Water Purchase Agreement between Morehead Utility Plant Board and Rowan Water at 7.

⁹ Analysis and Recommendations for Wholesale Water Rate, Table G.2.

¹⁰ Morehead’s Response to Staff’s Second Request, Item 2.

¹¹ Morehead’s Response to Staff’s Second Request, Item 2.

actual costs over a three-year period, otherwise known as the gradual implementation period.¹² The parties agreed that the performance of a cost-of-service study based upon actual costs during the fiscal year ending June 30, 2025, with the difference between the actual costs of water production and the \$3.61 per 1,000 gallons rate being divided by three and that amount being cumulatively added each year to the \$3.61 per 1,000 gallons rate in July 2026, July 2027, and July 2028.¹³ The Revised Agreements allow for additional cost-of-service studies based on the fiscal years ending June 30, 2026, 2027, and 2028 with the difference being allocated over the remainder of the gradual implementation period in the same manner as the initial difference.¹⁴

After the implementation of the July 2028 rates, the Revised Agreements allow for Morehead to, no more frequently than annually, adjust or modify the wholesale rates to Bath District and Rowan Water to reflect changes in Morehead's cost of providing wholesale service.¹⁵

Following the July 2025 increases, the Revised Agreements require Morehead to provide notice to Bath District and Rowan Water of any proposed rate adjustment at least 30 days prior to adopting the rate. After the 30-day notice period, the Revised Agreements state that Morehead may establish and adopt the rate to be charged. New

¹² Water Purchase Agreement between Morehead Utility Plant Board and Bath District at 7; Water Purchase Agreement between Morehead Utility Plant Board and Rowan Water at 7.

¹³ Water Purchase Agreement between Morehead Utility Plant Board and Bath District at 7; Water Purchase Agreement between Morehead Utility Plant Board and Rowan Water at 7.

¹⁴ Water Purchase Agreement between Morehead Utility Plant Board and Bath District at 7; Water Purchase Agreement between Morehead Utility Plant Board and Rowan Water at 7–8.

¹⁵ Water Purchase Agreement between Morehead Utility Plant Board and Bath District at 8; Water Purchase Agreement between Morehead Utility Plant Board and Rowan Water at 8.

rates would be effective no sooner than 30 days after Morehead adopts the rate to allow Morehead to file the revised rates with the Commission for approval.¹⁶

Finally, to the extent Bath District and Rowan Water provide retail water service to Morehead's sewer customers, the Revised Agreements contain a provision for Bath District and Rowan Water to discontinue water service to Morehead's delinquent sewer customers pursuant to KRS 96.930 to 96.943.¹⁷

DISCUSSION AND FINDINGS

Prior to the filing of the Revised Agreements, Morehead provided wholesale water service to Bath District and Rowan Water pursuant to a November 2000 Interlocal Agreement between the city of Morehead, Morehead Utility Plant Board, Rowan Water, and Bath District (Interlocal Agreement).¹⁸ The Interlocal Agreement provided a detailed methodology for allocating the cost of constructing and operating the proposed facilities and contained specific formulas to calculate each expense. The Interlocal Agreement further provided for a recalculation of the components annually based upon Morehead's actual expenses in the preceding fiscal year. The Revised Agreements will supersede the Interlocal Agreement.¹⁹

¹⁶ Water Purchase Agreement between Morehead Utility Plant Board and Bath District at 8; Water Purchase Agreement between Morehead Utility Plant Board and Rowan Water at 8.

¹⁷ Water Purchase Agreement between Morehead Utility Plant Board and Bath District at 9; Water Purchase Agreement between Morehead Utility Plant Board and Rowan Water at 9–10.

¹⁸ 2000 Interlocal Agreement (<https://psc.ky.gov/tariffs/Water/Districts,%20Associations,%20%26%20Privately%20Owned/Bath%20County%20%20Water%20District/xContracts/City%20of%20Morehead/2000%20Interlocal%20Agreement.pdf>).

¹⁹ Water Purchase Agreement between Morehead Utility Plant Board and Bath District at 12; Water Purchase Agreement between Morehead Utility Plant Board and Rowan Water at 12.

Based on the evidence of record, and due to the reasons set forth below, the Commission finds that the Revised Agreements should be accepted, and the rates therein are fair, just and reasonable. The Commission notes that cost-of-service studies are an accepted methodology for allocating expenses across customer classes.

As noted above, the Commission approved the Phase 1 rates to be effective July 1, 2024, in the opening Order of this proceeding. Regarding the Phase 2 rates scheduled to be effective July 1, 2025, Morehead provided, as part of its cost-of-service study, a wholesale rate computation based on its existing assets and a new regional water treatment plant that supported a rate of \$4.74 per 1,000 gallons. As stated above, Morehead later updated this amount based on grant funding it received, resulting in a cost based calculated rate of \$4.0001 per 1,000 gallons. The Phase 2 rate was based on existing assets plus the new regional water treatment plant. Morehead estimated the cost of the new regional water treatment plant to be approximately \$52 million. As noted above, the parties agreed to a lesser Phase 2 rate of \$3.61 per 1,000 gallons beginning with service provided in July 2025, with the understanding that another cost-of-service study would be performed based upon actual costs for the fiscal year ending June 30, 2025. As the Agreement states, any difference between the \$3.61 per 1,000 gallons rate and the rate supported by the cost-of-service study for the fiscal year ending June 30, 2025, would be spread out over the next three years beginning in July 2026.

The Commission finds the gradual rate increases proposed by Phase 2 to be reasonable as it ensures that the known and measurable wholesale rate increases to Bath District and Rowan Water are implemented gradually. In addition, the performance of a cost-of-service study will provide a measurable cost based foundation for any future

requested rate adjustments to ensure the parties pay the appropriate allocation of expenses from all parties benefitting from the new regional water treatment plant. Morehead stated that the rates effective July 2026, 2027, and 2028 would not exceed the rates reflected in any cost-of-service study conducted during that period.²⁰ Morehead also indicated that it would meet with Bath District and Rowan Water prior to each subsequent rate revision resulting from the gradual implementation section of the Revised Agreements.²¹ Lastly, Morehead confirmed it would file updated tariff sheets with the Commission for such revisions and submit to the Commission copies of all information presented to Bath District and Rowan Water.²²

In Case No. 2007-00299,²³ the Commission stated that the formula contained within the Interlocal Agreement was the rate for wholesale water service and that since the formula remained unchanged since the Interlocal Agreement's execution, KRS 278.180(1) did not require 30 days' notice to the Commission of the recalculated cost components.²⁴ However, as discussed below, the Revised Agreements do not contain formula rates, thus the Commission finds that Morehead should file revised tariff sheets with the Commission prior to placing any new rates into effect.²⁵ As the Revised Agreements do not contain a specific formula for the rates like the Interlocal Agreement

²⁰ Morehead's Response to Staff's First Request, Item 3(a).

²¹ Morehead's Response to Staff's First Request, Item 3(b).

²² Morehead's Response to Staff's First Request, Item 3(b)-(c).

²³ Case No. 2007-00299, *Purchased Water Adjustment of Bath County Water District (Ky, PSC Sept. 26, 2007)*.

²⁴ 2007-00299, Sept. 26, 2007 Order at 2.

²⁵ 2007-00299, Sept. 26, 2007 Order at footnote 3.

did, KRS 278.180(1) is applicable to any future revisions to the wholesale rate to Bath District and Rowan Water and such revisions will be subject to the Commission's review and approval. Therefore, for each future rate revision, Morehead should file with the Commission, at a minimum, a revised tariff sheet, customer notice that complies with 807 KAR 5:011, Section 8(4), and any supporting documentation.

KRS 96.930 to 96.943 requires a water supplier to disconnect water service to a municipal utility's delinquent sewer customer(s) after receiving written notice from the municipality. While the Revised Agreements are silent on notice to the customers of any disconnection due to non-payment of a delinquent sewer bill, Bath District and Rowan Water must comply with 807 KAR 5:006, Section 14(5) and Section 15(1)(f) which require that customers disconnected for non-payment of bills receive a mailed or otherwise delivered advance termination notice at least five days prior to service termination, and that such service shall not, for any reason be terminated before twenty days after the mailing date of the original unpaid bill.

IT IS THEREFORE ORDERED that:

1. The proposed Revised Agreements are approved for service rendered on and after July 2, 2024.
2. The Phase 2 rate of \$3.61 per 1,000 gallons is approved for service rendered on and after July 15, 2025, for Bath District and for service rendered on and after July 1, 2025, for Rowan Water.
3. For each future rate revision, Morehead shall file with the Commission, at a minimum, a revised tariff sheet, customer notice that complies with 807 KAR 5:011, Section 8(4), and any supporting documentation.

4. Within 20 days of the date of service of this Order, Morehead shall file with the Commission, using the Commission's electronic Tariff Filing System, new tariff sheets setting forth the rate and charge approved by this Order, its effective date, and stating that the rate and charge were authorized by this Order.

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

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PUBLIC SERVICE COMMISSION



Chairman

Commissioner



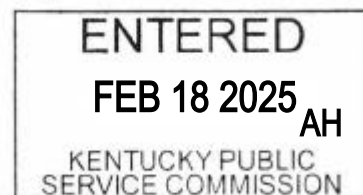
Commissioner

Commissioner John Will Stacy did not participate in the deliberations or decision concerning this case.

ATTEST:



Executive Director



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