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COMMISSION

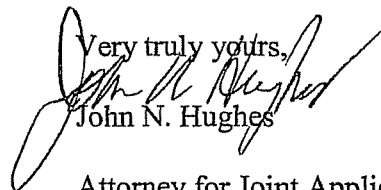
Beth O'Donnell
Executive Director
Public Service Commission
211 Sower Blvd.
Frankfort, KY 40601

Re: Case 2006-00327

Dear Beth:

Pursuant to the final order in this case, the Joint Applicants provide the attached responses to the Commission's conditions to closing of the transaction. Except for the final financial report from Sandy Valley Water District required in item 8; the applicants believe all other information is provided and all necessary actions completed. The financial report is being prepared and is expected to be filed by June 30, 2007. A copy of this response has been mailed to the intervenors - Attorney General and the city of Prestonsburg.

If there are any questions about this matter, please contact me.

Very truly yours,

John N. Hughes

Attorney for Joint Applicants

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE JOINT APPLICATION OF SANDY VALLEY)	
WATER DISTRICT, SOUTHERN WATER AND)	
SEWER DISTRICT AND THE CITY OF)	
PIKEVILLE FOR APPROVAL OF THE)	CASE NO. 2006-00327
TRANSFER OF FACILITIES AND FOR THE)	
ASSUMPTION OF DEBT BY SOUTHERN)	
WATER AND SEWER DISTRICT)	

ORDER

Sandy Valley Water District ("Sandy Valley District"), Southern Water and Sewer District ("Southern District"), and the city of Pikeville, Kentucky ("Pikeville") (jointly "Applicants") have applied to the Commission for authority to transfer Sandy Valley District's existing water assets and customers to Southern District and Pikeville. Southern District further applies for authority to assume certain portions of Sandy Valley District's debt obligations.

Having considered the application and evidence of record, the Commission finds that:¹

¹ The Joint Applicants tendered their application on June 29, 2006. Because of deficiencies in the application, the Commission did not accept the application for filing until September 22, 2006. Pursuant to KRS 278.020(6), the Commission has extended that statutory period for review of the application to 120 days. The Attorney General is the only party to intervene in this matter. He was afforded the opportunity to engage in discovery in this matter and to request a hearing. On September 28, 2006, he notified the Commission that he did not object to the proposed transfer, did not intend to conduct discovery and did not desire a hearing in this matter. Commission Staff has served interrogatories and requests for production of documents upon the Joint Petitioners. On January 11, 2007, the Commission conducted a public meeting in Betsy Lane, Kentucky to solicit public comment on the proposed transfer.

1. Sandy Valley District, a water district organized pursuant to KRS Chapter 74, owns and operates facilities that distribute water to customers in Floyd and Pike counties, Kentucky.²

2. As of December 31, 2005, Sandy Valley District provided water service to 2,335 customers.³ Approximately 1,202 of these customers are located in Pike County, Kentucky. The remaining 1,133 customers are located in Floyd County, Kentucky.

3. As of December 31, 2004, Sandy Valley District had net utility plant of \$2,363,946.⁴

4. Approximately 38 percent of Sandy Valley District's distribution mains are located in Floyd County. The remaining 62 percent of its distribution mains are located in Pike County. Sandy Valley District has four water storage tanks. Two of these tanks, a 150,000 gallon ground storage tank and a 200,000 ground storage tanks, are located in Floyd County. The other two storage tanks, which have the same storage capacity as those in Floyd County, are located in Pike County.

5. As of December 31, 2004, Sandy Valley District had total assets of \$2,476,034, total long-term debt of \$1,521,662, and current and accrued liabilities of \$175,599.⁵

² Annual Report of Sandy Valley Water District to the Public Service Commission for the Calendar Year Ended December 31, 2004 at 5.

³ Joint Applicants' Response to Commission Staff's First Set of Interrogatories and Requests for Production of Documents, Item 3(b). According to the last annual report that it submitted to the Commission, Sandy Valley District had 2,327 customers. See Annual Report of Sandy Valley Water District to the Public Service Commission for the Calendar Year Ended December 31, 2004 at 27.

⁴ Annual Report of Sandy Valley Water District to the Public Service Commission for the Calendar Year Ended December 31, 2004 at 7.

⁵ Id. at 9.

6. For the calendar year ending December 31, 2004, Sandy Valley District had total operating revenues of \$1,042,515, total utility operating expenses of 1,096,017, and total utility operating income of (\$53,502).⁶

7. Sandy Valley District has issued certain bonds and notes that Rural Development holds. As of August 22, 2006, outstanding principal on these bonds and notes is \$1,392,844.⁷

8. As of July 1, 2006, Sandy Valley District has an outstanding indebtedness of \$37,484.50 that is owed to the U.S. Economic Development Administration.⁸

9. Sandy Valley District does not produce any water, but purchases its total water supply from Prestonsburg and Pikeville.

10. Sandy Valley District does not provide any wastewater services.

11. No entity provides wastewater service in Sandy Valley District's territory.

12. Sandy Valley District has not filed with the Commission a financial and statistical report for calendar year 2005.⁹

13. As of October 18, 2006, Sandy Valley District held customer deposits of \$58,625 and owed accrued interest of \$5,568 on these deposits.¹⁰

⁶ Id. at 11.

⁷ Joint Applicants' Response to the Commission's Order of July 31, 2006, Exhibit 4.

⁸ Id.

⁹ Administrative Regulation 807 KAR 5:006, Section 3(1), requires "[e]very utility shall file annually a financial and statistical report upon forms to be furnished by the commission. This report shall be based upon the accounts set up in conformity with the uniform system of accounts for utilities."

¹⁰ Joint Applicants' Response to Commission Staff's First Set of Interrogatories and Requests for Production of Documents, Item 1.

14. Southern District is a water district organized pursuant to KRS Chapter 74 and owns and operates facilities that distribute water to approximately 6,160 customers in Floyd and Knott counties, Kentucky¹¹ and that provide sewer service to approximately 155 customers in Floyd County, Kentucky.¹²

15. As of December 31, 2005, Southern District had net utility plant of \$21,040,766 for its water operations.¹³

16. As of December 31, 2005, Southern District had total assets of \$25,857,148; total equity capital of \$18,049,914; and total liabilities of \$7,807,234.¹⁴

17. Southern District currently employs 20 persons to operate and manage its water and wastewater operations. The Kentucky Division of Water has certified three of these employees as Class IIIA water treatment plant operators, one employee as a Class IVA water treatment plant operator, and five employees as Class IIB or higher water distribution system operators.

18. Southern District has a water treatment capacity of 2 million gallons of water daily, has approximately 400 miles of water distribution main, and 3.13 million gallons of water storage capacity.¹⁵

¹¹ Annual Report of Southern Water District to the Public Service Commission for the Calendar Year Ended December 31, 2005 (Water Operations) at 5 and 27.

¹² Annual Report of Southern Water District to the Public Service Commission for the Calendar Year Ended December 31, 2005 (Sewer Operations) at 11-12.

¹³ Annual Report of Southern Water District to the Public Service Commission for the Calendar Year Ended December 31, 2005 (Water Operations) at 7.

¹⁴ Id. at 9.

¹⁵ Joint Applicants' Response to Commission Staff's First Set of Interrogatories and Requests for Production of Documents, Item 22.

19. Pikeville, a city of the third class,¹⁶ owns and operates water treatment and production facilities that provide water service to approximately 3,191 retail customers and three wholesale water customers.¹⁷ It also owns wastewater collection and treatment facilities that serve approximately 2,696 customers.

20. As of June 30, 2005, Pikeville's water operations had net assets of \$5,745,289 and its sewer operations had net assets of \$6,006,804.¹⁸

21. Pikeville contracts with Utility Management Group for the operation of its water facilities. Utility Management Group employs 14 persons to operate Pikeville's water facilities, including three Class IVA water treatment plant operators and four persons certified as a Class IID or higher distribution system.¹⁹ Pikeville also retains the services of O'Brian and Gere, Consulting Engineers.

22. Pikeville owns and operates a water treatment plant that has a capacity of 6.5 million gallons per day.²⁰

¹⁶ KRS 81.010(3).

¹⁷ Joint Application at ¶ 3.

¹⁸ Joint Applicants' Response to Commission Staff's First Set of Interrogatories and Requests for Production of Documents, Item 9 at 9.

¹⁹ Joint Applicants' Response to Commission Staff's First Set of Interrogatories and Requests for Production of Documents, Item 9.

²⁰ Big Sandy Area Development District, Comprehensive Economic Development Strategy: Progress Kentucky 2005 Update (June 2005) at 89 (found at http://www.pikecountychamber.org/dev/2005_master_file.pdf) (last visited Jan. 19, 2007).

23. On January 1, 2006, Floyd County Fiscal Court, Sandy Valley District, Southern District, and Pikeville entered into an Interlocal Cooperation Agreement that provides:

a. Sandy Valley District will apply to the Commission for approval of the transfer to Southern District of all of Sandy Valley District assets located in Floyd County, Kentucky and all liabilities associated with these assets.²¹

b. Sandy Valley District will apply to the Commission for approval of the transfer to Pikeville all of Sandy Valley District assets located in Pike County, Kentucky and all liabilities associated with these assets.

c. Effective February 1, 2006, Sandy Valley District authorizes Pikeville to assume responsibility for the day-to-day operations of Sandy Valley District's facilities. Until Commission approval of the proposed transfer of Sandy Valley District's assets, Sandy Valley District retains control of its facilities and responsibility for all financial obligations related to those facilities.

d. Upon Commission approval of the proposed transfer, Southern District and Pikeville will integrate Sandy Valley District's facilities into their respective utility operations.

e. Southern District and Pikeville will retain all Sandy Valley District employees who are employees as of January 1, 2006, for a period of at least one year following Commission approval of the proposed transfer. These employees shall be paid at their existing rate of pay.

²¹ The Interlocal Cooperation Agreement contains no provision that expressly requires Sandy Valley District to transfer its assets to either Southern District or Pikeville.

f. For a period of one year following Commission approval of the proposed transfer, Southern District and Pikeville will provide water service to Sandy Valley District customers at Sandy Valley District's present rates.²²

g. Pikeville will sell potable water to Southern District for retail sale in Floyd County at the same volumes and at same rate that the Commission had authorized Pikeville to sell to Sandy Valley District as of May 26, 2004.²³

h. Pikeville and the Floyd County Fiscal Court will jointly apply for \$2,000,000 in Community Development Block Grant Funds to be used to finance the extension of Pikeville's sewer collection system to serve the communities of Harold, Betsy Lane, and Mare Creek in Floyd County, Kentucky.

i. Pikeville will act as the lead applicant and project administrator on all funding from federal and state sources to finance the extension.

j. Upon funding and construction of the proposed extension of Pikeville's sewer collection system, Pikeville will convey ownership to Southern District of that portion of the sewer collection system located in Floyd County, Kentucky. Southern District will accept ownership and responsibility for that portion of the sewer collection system and will assume responsibility for any portion of debt related to that

²² The Interlocal Agreement expressly refers to the rates that the Commission approved in Case No. 2004-00156. See Case No. 2004-00156, Purchased Water Adjustment of Sandy Valley Water District (Ky.PSC May 26, 2004).

²³ Our review of Commission records does not review any action taken on May 26, 2004 regarding Pikeville's rates or service to Sandy Valley District. On July 5, 1999, Sandy Valley District and Pikeville entered a Water Purchase Contract that provided that Pikeville would furnish Sandy Valley District's water requirements not exceeding 27,000,000 gallons per month and at a rate of \$1.69 per 1,000 gallons. Pikeville submitted this contract to the Commission on November 22, 1999. It became effective on December 22, 1999. As of the date of this Order, the provisions of this contract remain in effect.

portion of the sewer collection system. Pikeville will accept all sewage flows associated with that portion of the sewer collection system located in Floyd County, Kentucky.

k. For the proposed extension of the sewage collection system to achieve the lowest rates, a single entity should be responsible for both water and wastewater services.

24. On December 22, 2005, Sandy Valley District's Board of Commissioners voted to accept the Interlocal Cooperation Agreement and authorized its chairman, Joseph Jacobs, to execute all documents related to the Agreement.²⁴

25. Based upon an agreement between Southern District and Pikeville, Sandy Valley District's outstanding debt will be allocated in the following manner: 43 percent to Southern District and 57 percent to Pikeville. This allocation is based upon the percentage of Sandy Valley District's total revenues from retail sales to customers in Floyd and Pike counties.²⁵

26. Based upon an agreement between Southern District and Pikeville, Sandy Valley District's customer deposit liabilities and funds will be allocated between the two entities based upon the location of the customers who have made deposits.²⁶

²⁴ Joint Application, Exhibit 3. The Commission finds no evidence to suggest that the Sandy Valley District's Board of Commissioners were not properly constituted and qualified to act upon the motion. Present at the meeting were the following members of Sandy Valley District's Board of Commissioners: Jeff Anderson, Oliver Blackburn, Tom Bow, Joseph Jacobs, and Tommy Kidd. According to the Sandy Valley District's most recent annual report, the terms of Commissioners Bow and Jacobs' terms had expired at the time of the meeting. The terms of the remaining members, however, had not. Commissioner Bow and Jacobs would continue to serve until their successors had been appointed and qualified. KRS 65.008. We find no evidence that the Floyd or Pike County Judge Executives had appointed and the respective Fiscal Courts had approved successors to Commissioners Bow and Jacobs.

²⁵ Joint Applicants' Response to Commission Staff's First Set of Interrogatories and Requests for Production of Documents, Item 3.

²⁶ Id. at Item 1(c).

27. Based upon Sandy Valley District's customer deposit liability as of October 18, 2006, \$23,565 of Sandy Valley District's customer deposits and an accrued interest obligation of \$2,542 will be transferred to Southern District.²⁷ Southern District intends to pay all accrued interest on these deposits and to continue holding the deposits.²⁸

28. Based upon Sandy Valley District's customer deposit liability as of October 18, 2006, \$35,050 of Sandy Valley District's customer deposits and an accrued interest obligation of \$3,026 will be transferred to Pikeville.²⁹ Pikeville intends to pay all accrued interest on these deposits and to refund the deposits.³⁰

29. Pikeville and Southern District have requested that the Rural Development and the U.S. Economic Development Administration permit their assumption of Sandy Valley District's outstanding obligations based upon their agreed allocation. Neither federal agency has yet approved these requests.

30. The amount of indebtedness that Southern District will assume does not exceed the value of the assets that Southern District will receive as a result of the transfer of Sandy Valley District's facilities and equipment.

31. Reduction of the number of operating water districts in the Commonwealth is in the public interest as such reduction "will tend to eliminate wasteful duplication of costs and efforts, result in a sounder and more businesslike degree of management,

²⁷ Id. at Item 1(a).

²⁸ Id. at Item 2.

²⁹ Id. at Item 1(b).

³⁰ Id. at Item 2.

and ultimately result in greater economies, less cost, and a higher degree of service to the general public.”³¹

32. The proposed transfer will allow for the consolidation of water and wastewater services in the area that Sandy Valley District currently serves and will better facilitate the development of wastewater services in that area.

33. Southern District’s proposed assumption of Sandy Valley District’s outstanding debt obligations is for lawful objects within the corporate purpose of Southern District’s utility operation, is necessary and appropriate for and consistent with the proper performance of Southern District’s service to the public and will not impair Southern District’s ability to perform that service, is reasonably necessary and appropriate for such purpose, and should be approved.

34. Southern District proposes to record the transaction in the following manner:

<u>Description</u>	<u>Debit</u>	<u>Credit</u>
Cash	\$XXX	
Accounts Receivable	XXX	
Land	XXX	
Office Furnishings	XXX	
Plant, Tools & Equipment	XXX	
Retained Earnings	XXX	
Accumulated Depreciation		\$XXX
Accounts Payable		XXX
Payroll Taxes Payable		XXX
Other Liabilities		XXX
Customer Deposits		XXX
Note Payable – RD		XXX
Note Payable – EDA		XXX
Donated Capital		XXX

35. Southern District’s proposed accounting entry to record the transaction is not consistent with the Uniform System of Accounts for Class A/B Water Districts and

³¹ KRS 74.361(1). See also KRS 224A.300(1) and 224A.310.

Associations. Southern District should record a plant acquisition adjustment instead of an entry to Retained Earnings. This plant acquisition adjustment should be amortized over the remaining useful life of the acquired assets purchased. Annual amortization may be recorded in Account 406, Amortization of Utility Plant Acquisition Adjustment.

Based upon these findings, the Commission makes the following conclusions of law:

1. Sandy Valley District and Southern District are utilities that are subject to Commission jurisdiction.³²
2. Pikeville is not a utility as defined in KRS 278.010(3) and is therefore currently not subject to Commission regulation.³³
3. Southern District and Pikeville are “persons” for purposes of KRS Chapter 278.³⁴
4. KRS 278.020(5) provides that “[n]o person shall acquire or transfer ownership of, or control, or the right to control, any utility under the jurisdiction of the commission . . . without prior approval by the commission.” As Southern District and Pikeville are persons and are acquiring ownership of Sandy Valley District’s water distribution facilities, this statute is applicable to and requires Commission approval of the proposed transfer.
5. KRS 278.020(6) provides that “[n]o individual, group, syndicate, general or limited partnership, association, corporation, joint stock company, trust, or other entity (an “acquirer”), whether or not organized under the laws of this state, shall acquire

³² KRS 278.010(3)(d); KRS 278.015; KRS 278.040.

³³ KRS 278.010(3)(f).

³⁴ KRS 278.010(2).

control, either directly or indirectly, of any utility furnishing utility service in this state, without having first obtained the approval of the commission.” As Southern District and Pikeville are acquiring control of Sandy Valley District’s utility operations through the acquisition of the facilities that Sandy Valley District uses to provide utility service, this statute is applicable to and requires Commission approval of the proposed transfer.

6. Southern District and Pikeville have the financial, technical, and managerial abilities to provide reasonable water service to Sandy Valley District customers.

7. The proposed transfer is in accordance with law and for a proper purpose; it will, however, be consistent with the public interest only if the conditions set forth in Ordering Paragraph 1 of this Order are met.

8. KRS 278.218(1) prohibits a person from acquiring or transferring “ownership of or control, or the right to control any assets that are owned by a utility as defined under KRS 278.010(3)(a) without prior approval of the commission, if the assets have an original book value of one million dollars (\$1,000,000) or more and . . . [t]he assets will continue to be used to provide the same or similar service to the utility or its customers.”

9. KRS 278.218(1) is not applicable to the proposed transaction as none of the facilities to be transferred are used for or in connection with “[t]he generation, production, transmission or distribution of electricity to or for the public, or compensation, for lights, heat, power, or other uses.”³⁵

³⁵ KRS 278.010(3)(a).

10. Upon completion of the proposed transfer, those facilities transferred to Pikeville shall cease to be subject to Commission jurisdiction.

IT IS THEREFORE ORDERED that:

1. The proposed transfer of Sandy Valley District's facilities to Southern District and Pikeville, as described in the Joint Application and the Joint Applicants' responses to discovery requests, is approved subject to the conditions set forth below:

a. The transfer shall not occur until Rural Development and the U.S. Economic Development Administration has approved Sandy Valley District's delegation of all obligations arising out of its outstanding debt to Pikeville and Southern District and releases Sandy Valley District of all obligations related to that debt.

b. Southern District and Pikeville shall retain as employees all persons whom Sandy Valley District employed as of January 1, 2006, for a period of at least one year following the date of the transfer and shall pay those persons at a rate that is not less than their pay rate on the date of this Order.

c. For a period of one year following the date of the transfer, Southern District and Pikeville shall provide retail water service to Sandy Valley District customers at rates that do not exceed Sandy Valley District's present rates. Thereafter, any adjustments to the rates that Southern District or Pikeville assess to current Sandy Valley District customers for water service shall be made only upon Commission approval or after the performance of a cost-of-service analysis that is prepared by a certified public accountant or other qualified person and whose findings support the proposed adjustment.

d. Unless authorized or directed by the Commission, Pikeville will furnish to Southern District for retail sale in Floyd County up to 27 million gallons of potable water monthly and at a rate of \$1.69 per 1,000 gallons.

e. Within 30 days of the date of the transfer, Pikeville shall refund all customer deposits that Sandy Valley District presently holds for customers located in Pike County and shall pay accrued interest on those customer deposits. Within 15 days of this action, Pikeville shall advise the Commission in writing that the required refunds have been made.

f. Within 30 days of the date of the transfer, Southern District shall pay accrued interest on all customer deposits that Sandy Valley District presently holds for customers located in Floyd County. Within 15 days of this action, Southern District shall advise the Commission in writing that the required interest payments have been made.

g. Southern District and Pikeville shall each establish an office in the area that Sandy Valley District presently serves to receive customer payments, answer customer questions, resolve disputes and negotiate partial payment plans or shall designate a representative in the area who has such office and is authorized to perform such actions.

2. The proposed transfer shall not proceed unless, within 20 days of the date of this Order, written acknowledgements on behalf of Southern District and Pikeville by each entity's chief executive officer accepting and agreeing to be bound by the conditions set forth in Ordering Paragraph 1 are filed with the Commission.

3. Southern District is authorized to assume 43 percent of the outstanding amount of Sandy Valley District's obligations, as of the date of the transfer, to Rural

Development and the U.S. Economic Development Administration, but shall not assume total obligations exceeding \$615,041.

4. Southern shall use the following journal entry (with account balances updated through the date of the transfer) to record the acquisition:³⁶

<u>Description</u>	<u>Debit</u>	<u>Credit</u>
Cash	\$XXX	
Accounts Receivable	XXX	
Land	XXX	
Office Furnishings	XXX	
Plant, Tools & Equipment	XXX	
Plant Acquisition Adjustment	XXX ³⁷	
Accumulated Depreciation		\$XXX
Accounts Payable		XXX
Payroll Taxes Payable		XXX
Other Liabilities		XXX
Customer Deposits		XXX
Note Payable – RD		XXX
Note Payable – EDA		XXX
Donated Capital		XXX

5. Within 10 days of completion of the proposed transfer of assets to Southern District, Sandy Valley District and Southern District shall notify the Commission in writing of the completion of the transfer of assets.

6. Within 10 days of completion of the proposed transfer of assets to Pikeville, Sandy Valley District and Pikeville shall notify the Commission in writing of the completion of the transfer of assets.

³⁶ This journal entry is for accounting purposes only and is not binding upon the Commission for determining the proper rate-making treatment of the plant acquisition adjustment.

³⁷ Plant Acquisition Adjustment should be entered as a debit if the sum of Accumulated Depreciation, Accounts Payable, Payroll Taxes Payable, Other Liabilities, Customer Deposits, Note Payable – RD, Note Payable – EDA, and Donated Capital exceeds the sum of Cash, Accounts Receivable, Land, Office Furnishings, and Plant, Tools & Equipment. Otherwise it should be entered as a credit.

7. Within 60 days of the date of this Order, Sandy Valley District shall submit to the Commission a financial and statistical report for calendar years 2005 and 2006.

8. Sandy Valley District shall submit to the Commission a financial and statistical report for the period in calendar year 2007 that it owned and operated the system.

9. Within 10 days of the completion of the proposed transfer, Southern District shall file with the Commission the journal entry that it proposes to record the acquisition. The acquisition shall be recorded in accordance with the Uniform System of Accounts for Class A/B Water Districts and Associations.³⁸

Done at Frankfort, Kentucky, this 22nd day of January, 2007.

By the Commission

ATTEST



Executive Director

³⁸ The current version of the Uniform System of Accounts for Class A/B Water Districts and Associations can found at <http://psc.ky.gov/agencies/psc/forms/usoa/0700ab02.pdf>.