

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF SOUTHERN WATER AND)
SEWER DISTRICT FOR AN ADJUSTMENT IN) CASE NO. 2012-00309
RATES PURSUANT TO THE ALTERNATIVE RATE)
FILING PROCEDURE FOR SMALL UTILITIES)

ORDER

Southern Water and Sewer District ("Southern District") has applied for an adjustment of its rates for water and sewer service. By this Order, the Commission establishes interim rates for water and sewer service.

On August 8, 2012, Southern District submitted an application for a rate adjustment pursuant to 807 KAR 5:076. This application addressed rates for its water and sewer operations. The Commission accepted this application for filing purposes on September 14, 2012.

After reviewing the application and Southern District's records, Commission Staff issued a report containing its findings and recommendations on November 1, 2012. It recommended approval of Southern District's proposed rates for sewer service.¹ Unable to reach a conclusion regarding the reasonableness and lawfulness of the water district's annual payment of \$100,000 to Floyd County Fiscal Court to assist Floyd County in servicing certain bonded debt, Commission Staff provided alternative

¹ Commission Staff Report on Southern Water and Sewer District ("Commission Staff Report") at 3 (filed Nov. 1, 2012).

recommendations regarding Southern District's proposed rates for water service.² Commission Staff also recommended that the Commission direct Southern District to revise its method for calculating and recording depreciation expense for accounting and ratemaking purposes and to revise certain accounting procedures and internal controls.³

The Attorney General ("AG")⁴ and Southern District have submitted comments on Commission Staff's findings and recommendations. In his comments, the AG questioned the lawfulness and reasonableness of certain payments that Southern District had made on an annual basis to assist Floyd County Fiscal Court in meeting certain bonded debt obligations. He also expressed concern regarding the magnitude of Southern District's water loss and recommended that the Commission direct the water district to submit a plan for reducing water loss. The AG stated that the matter may be submitted for decision without a hearing.⁵

In its response to Commission Staff's report, Southern District did not comment on Commission Staff's alternative rate proposals or address the question of the lawfulness and reasonableness of its annual payments to Floyd County Fiscal Court. It stated its "agreement with the Commission's Staff report," requested that a decision be made on the existing record, and expressly waived any right to a hearing.⁶

² *Id.* at 3. Commission Staff provided two schedules of water rates for the Commission's consideration. One schedule would produce revenues sufficient to meet reasonable operating expense, service Southern District's outstanding debt, and make the annual payment. The other would generate a level of revenues that excluded any revenues to cover the annual payment.

³ Commission Staff Report Attach. A at 10.

⁴ On October 10, 2012, the AG moved to intervene in this matter. The Commission granted his motion the following day.

⁵ AG's Written Comments on Report of Commission Staff at 1.

⁶ Letter from Paula Johnson, Chairperson, Southern Water and Sewer District, to Jeff Derouen, Executive Director, Public Service Commission (filed Nov. 5, 2012).

As both parties to the proceeding waived their right to a hearing and stated that this matter may be submitted for decision on the existing record, pursuant to the provisions of the Commission's Order of October 5, 2012, this matter now stands submitted for decision.

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

1. Southern District is a water district organized pursuant to KRS Chapter 74.
2. Southern District owns and operates facilities that produce and distribute water to 7,377 customers in Floyd and Knott counties, Kentucky.⁷ It also owns and operates facilities that provide sewer service to 198 customers.⁸
3. The calendar year ending December 31, 2010 should be used as the test period to determine the reasonableness of Southern District's existing and proposed rates.⁹
4. Based upon pro forma test-period operations, Southern District's pro forma total operating expenses for its sewer operations, after adjusting for known and measurable changes, is \$190,769.¹⁰

⁷ *Annual Report of Southern Water and Sewer District (Water Division) to the Public Service Commission for the Calendar Year Ended December 31, 2011* at 5 and 27.

⁸ *Annual Report of Southern Water and Sewer District (Sewer Division) to the Public Service Commission for the Calendar Year Ended December 31, 2011* at 12.

⁹ Southern District filed its application pursuant to 807 KAR 5:076. Section 8 of that regulation requires that "[t]he reasonableness of the proposed rates shall be determined using a twelve (12) month historical test period, adjusted for known and measurable changes, that coincides with the reporting period of the applicant's annual report for the immediate past year." Pursuant to Southern District's request, the Commission on September 14, 2012, granted Southern District's request for deviation from 807 KAR 5:076, Section 8.

¹⁰ App. Attach. C, Table C2.

5. Given that Southern District is a water district, the use of the debt-service coverage methodology to calculate its revenue requirement is appropriate and consistent with the Commission's historic ratemaking practices.

6. Applying the debt service coverage requirements to a five-year average of Southern District's principal and interest payments results in an annual revenue requirement for sewer operations of \$195,523.¹¹

7. Based upon pro forma test-period operations, Southern District's pro forma annual revenue from its sewer operations is \$100,038.¹² Approximately \$95,215 of this revenue is from sewer service.

8. Based upon pro forma test-period operations, Southern District's present sewer rate revenue is \$95,484 less than its revenue requirement.

9. Based upon pro forma test-period operations, Southern District's proposed rates will produce sewer revenues of \$114,258, an increase of 20 percent over test-period normalized revenues from sewer service.¹³

10. Southern District's proposed rates will increase the monthly sewer bill of a customer who uses 5,000 gallons of water from \$47.44 to \$56.94, or 20 percent.

¹¹ Total revenue requirement was determined by adding pro forma operating expenses to annual debt service of \$4,754. See App. Attach. D, Table D3. Annual debt service includes the five-year average of all principal and interest payments on all debts existing at the time the Application was filed that were either directly assigned or allocated to Southern District's sewer operations. It also includes the debt-service coverage requirement of Southern District's lending agencies and the administrative fee that Kentucky Infrastructure Authority assesses.

¹² \$95,215 (Revenue from Sewer Service) + \$3,662 (Other Operating Revenue) + \$1,161 (Nonutility Income) = \$100,038.

¹³ App. Attach. E at 5.

11. Southern District's proposed rates for sewer service, which are set forth in the Appendix to this Order, will produce sufficient revenues for Southern District to remain in compliance with all outstanding debt instrument obligations.¹⁴

12. Based upon pro forma test-period operations, Southern District's pro forma total operating expenses for its water operations, after adjusting for known and measurable changes, is \$3,324,165.¹⁵

13. Applying the debt-service coverage requirements to a five-year average of Southern District's principal and interest payments results in an annual revenue requirement for water operations of \$3,807,228.¹⁶

14. Our determination of annual revenue requirement for water operations does not include Southern District's annual payment of \$100,000 to Floyd County Fiscal Court to assist Floyd County Fiscal Court in meeting the debt service payments on bonds that Floyd County Fiscal Court issued to finance partially the construction of certain water improvements for Southern District.¹⁷

15. Southern District has not presented any evidence of the existence of any agreement between Southern District and Floyd County Fiscal Court regarding the bond issuance or Southern District's obligation to make an annual payment of \$100,000.

¹⁴ Commission Staff Report at 13.

¹⁵ App. Attach. C, Table C1.

¹⁶ $\$3,807,228 = \$3,324,165$ (Pro Forma Operating Expenses) + $\$483,063$ (Annual Debt Service Requirement). For calculation of annual debt service, see App. Attach. D, Table D3. Annual debt service includes the five-year average of principal and interest payments on all debts existing at the time the Application was filed that were either directly assigned or allocated to water operations. It also includes the coverage requirements of the lending agencies and the administrative fee that Kentucky Infrastructure Authority assesses.

¹⁷ See App. Attach. H; Commission Staff Report at 8-10.

16. In the absence of any agreement, the lawfulness and reasonableness of the payment cannot be ascertained and the amount should be excluded pending further investigation.

17. Based upon pro forma test-period operations, Southern District's pro forma annual revenue from its water operations is \$3,255,496.¹⁸ Approximately \$3,090,360 of this revenue is from water sales.

18. Based upon pro forma test-period operations, Southern District's present water operations revenue is \$551,732 less than its revenue requirement.¹⁹

19. Based upon pro forma test-period operations, Southern District's proposed rates for water service will produce revenues of \$3,907,508.²⁰

20. Southern District's proposed rates for water service will produce revenues in excess of that found reasonable and should not be authorized for water service pending completion of the Commission's investigation into Southern District's annual payment to Floyd County Fiscal Court.

21. The rates for water service set forth in the Appendix to this Order will produce total annual revenues of \$3,807,664.²¹

¹⁸ App. Attach. D, Table D1. \$3,090,360 (Revenue from Water Sales) + \$118,404 (Other Operating Revenue) + 2,242 (Gain on the Sale of Service Vehicles) + \$6,936 (Interest and Dividend Income) + \$37,554 (Nonutility Income) = \$3,255,496.

¹⁹ \$551,732 = \$3,807,228 (Total Revenue Requirement) - \$3,255,496 (Total Revenue-Water Operations).

²⁰ App. Attach. E at 3. \$3,742,372 (Revenue from Water Sales) + \$118,404 (Other Operating Revenue) + 2,242 (Gain on the Sale of Service Vehicles) + \$6,936 (Interest and Dividend Income) + \$37,554 (Nonutility Income) = \$3,907,508.

²¹ Commission Staff Report App. C. \$3,642,628 (Revenue from Water Sales) + \$118,404 (Other Operating Revenue) + 2,242 (Gain on the Sale of Service Vehicles) + \$6,936 (Interest and Dividend Income) + \$37,554 (Nonutility Income) = \$3,807,764.

22. The rates for water service set forth in the Appendix to this Order will produce annual revenues from retail sales of \$3,587,380,²² an increase of 17.88 percent.

23. These rates for water set forth in the Appendix to this Order will increase the monthly water bill of a retail customer who uses 5,000 gallons of water monthly from \$41.00 to \$47.87.

24. The rates for water service set forth in the Appendix to this Order will produce sufficient revenues for Southern District to remain in compliance with all outstanding debt-instrument obligations.²³

25. The record of this proceeding should be reopened, and further investigation should be made into Southern District's annual payments to Floyd County Fiscal Court to determine the appropriateness of their recovery through water service rates.

26. Pending completion of that investigation, Southern District should be permitted to charge the rates set forth in the Appendix to this Order for water and sewer service on an interim basis. Delay in allowing those rates to become effective, subject to change, may materially impair or damage Southern District's credit or operations.

27. A decision on the other issues in this proceeding, including Commission Staff's recommendations regarding revisions to Southern District's method for calculating and recording depreciation expense for accounting purposes and to certain accounting procedures and internal controls and the AG's request regarding Southern

²² Commission Staff Report App. C. $\$3,587,380 = \$3,784,597$ (Total Retail Sales) - $\$197,217$ (Billing Adjustments).

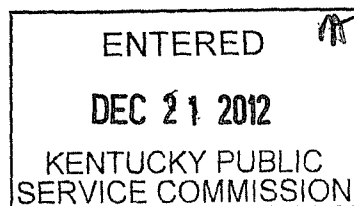
²³ Commission Staff Report at 11-12.

District's water losses, should be deferred until completion of the investigation into Southern District's payments.

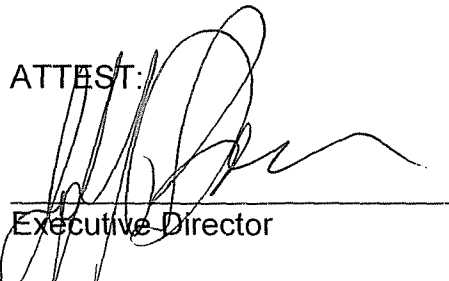
IT IS THEREFORE ORDERED that:

1. The rates set forth in the Appendix to this Order are, subject to change, approved for water and sewer service that Southern District renders on and after the date of this Order.
2. Within 20 days of the date of this Order, Southern District shall file revised tariff sheets with the Commission setting forth the rates approved in this Order.
3. The record of this proceeding is reopened to take additional evidence regarding the lawfulness and reasonableness of annual payments that Southern District presently makes to Floyd County Fiscal Court.
4. No later than February 15, 2013, Commission Staff shall file with the Commission a detailed report on Southern District's annual payment to Floyd County Fiscal Court and shall include in such report all documents and other evidence that it has collected regarding such payments.
5. A ruling upon all other issues presented in the Commission Staff Report and the AG's Comments is deferred.

By the Commission



ATTEST:


Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2012-00309 DATED DEC 21 2012

The following rates and charges are prescribed for the customers in the area served by Southern Water and Sewer 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 WATER RATES

First	2,000 gallons	\$23.48 Minimum Bill
Over	2,000 gallons	8.13 per 1,000 gallons

MONTHLY SEWER RATES

First	2,000 gallons	\$28.38 Minimum Bill
Over	2,000 gallons	9.52 per 1,000 gallons

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