

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF NORTH MANCHESTER WATER)
ASSOCIATION FOR APPROVAL OF PROPOSED) CASE NO. 2011-00441
INCREASE IN RATES FOR WATER SERVICE)

NOTICE OF FILING OF COMMISSION STAFF REPORT

Pursuant to the Commission's Order of December 22, 2011, Commission Staff files the attached report containing its findings and recommendations regarding the Applicant's proposed rate adjustment.



Jeff Derouen
Executive Director
Public Service Commission
P.O. Box 615
Frankfort, KY 40602

DATED FEB 15 2012

cc: Parties of Record

STAFF REPORT ON THE PROPOSED RATE ADJUSTMENT OF
NORTH MANCHESTER WATER ASSOCIATION

CASE NO. 2011-00441

On November 4, 2011, North Manchester Water Association ("North Manchester") filed with the Commission an application to adjust its current rates for water service. Using its historical operations for the calendar year ending December 31, 2010, and adjusting for known and measureable changes, North Manchester proposes rates that will reportedly produce additional revenues from water sales of \$65,524, an increase of 8.45 percent over normalized revenues from water sales. For a customer who purchases 5,000 gallons of water monthly, his monthly bill will increase from \$33.30 to \$36.13, or approximately 8.5 percent.

Commission Staff members, Sam Bryant and Sam Reid, performed a limited financial review of North Manchester's test-year operations to determine whether test-period operating revenues and expenses are representative of normal operations and the proposed adjustments are reasonable.¹ They did not pursue and have not addressed in this report insignificant or immaterial discrepancies. Where they have not expressly addressed a test-period expense, they found insufficient evidence to contest the reasonableness of that expense.

This report summarizes Commission Staff's review and recommendations. Mr. Reid reviewed North Manchester's normalized revenue adjustment and proposed rate design. Mr. Bryant addresses all pro forma expense adjustments and the revenue requirement determination. North Manchester's pro forma operating income statement

¹ Mr. Bryant and Mr. Reid inspected North Manchester's records while assisting North Manchester in the preparation of its rate application.

is set forth in Appendix A. In Appendix B, Commission Staff explains each of its proposed pro forma adjustments. Commission Staff's calculation of North Manchester's revenue requirements is shown at Appendix C. Commission Staff's recommended rates are found at Appendix D.

The Commission has historically used the Debt Service Coverage ("DSC") methodology to determine the revenue requirement for water districts and water associations. This approach is used primarily because a bond ordinance or loan agreement requires the water district or association to maintain a predetermined DSC level. North Manchester currently has long-term loan agreements with the Kentucky Infrastructure Authority and a local bank. Therefore, Commission Staff recommends that the Commission use a debt-service coverage ratio of 1.2 to determine North Manchester's revenue requirements. The Commission has previously found that this ratio is sufficient for a water association or district to cover its reasonable operating expenses, meet its debt service requirements, and provide for reasonable equity growth.

Based upon its review, Commission Staff finds that North Manchester's pro forma operating expenses are \$650,878 and its debt service requirement is \$150,982. Using a debt service coverage ratio of 1.2, North Manchester's total revenue requirement from water sales is \$831,163, an increase of \$56,080, or 7.2 percent above normalized revenue from water sales of \$775,083.

Commission Staff reviewed the billing analysis of North Manchester's test-period sales, which is contained in North Manchester's application, and concurs with the analysis's methodology and results. Commission Staff finds that, based upon test-

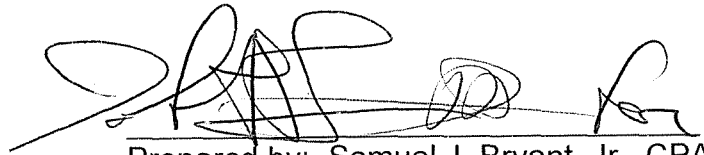
period sales, North Manchester's proposed rates will produce revenues of \$840,607. The rates set forth in Appendix D will generate annual revenues from water sales of \$831,163.

Neither North Manchester nor Commission Staff performed a cost-of-service study in this case. As North Manchester's current rates are based upon a cost-of-service that was conducted in 2010 and that the Commission found reasonable,² Commission Staff finds that a cost-of-service study is unnecessary in this case. It agrees with North Manchester's proposal that each rate block within the current rates be increased by an equal percentage derived from the percentage increase in revenue requirement over test-period normalized revenues. Accordingly, the rates set forth in Appendix D reflect a 7.2 percent increase to each rate block of North Manchester's current rates.

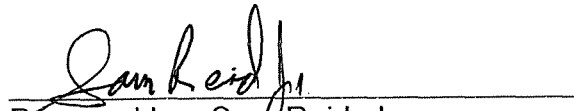
In summary, Commission Staff recommends that North Manchester's proposed rates be denied and that that rates set forth in Appendix D be approved. The rates in Appendix D will produce total revenues from water sales of \$831,163 and will allow North Manchester sufficient revenues to cover its reasonable operating expenses, service its debt, and provide for equity growth.

² Case No. 2010-00118, *Application of North Manchester Water Association For Approval of Increased Rates For Water Service* (Ky. PSC Jun. 15, 2010).

Signatures



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Prepared by: Sam Reid, Jr
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APPENDIX A
STAFF REPORT, CASE NO. 2011-00441
PRO FORMA OPERATIONS

	2010 Operations	Pro Forma Adjustment	Adj	Pro Forma Operations
Operating Revenues:				
Residential Sales	\$ 687,600	\$ 62,030	(A)	\$ 749,630
Commercial Sales	25,453			25,453
Other Water Revenue	<u>\$ 893</u>			<u>\$ 893</u>
Total Operating Revenues	\$ 713,946	\$ 62,030		\$ 775,976
Water Expenses:				
Salaries and Wages	114,173	0		114,173
Salaries & Wages-O&D	31,990	0		31,990
Benefits-Health Insurance		44,486	(B)	44,486
Purchased Water	272,924	(73,230)	(C)	199,694
Purchased Power	53,843	(25,553)	(D)	28,290
Chemicals	1,882	0		1,882
Materials & Supplies	29,515	12,370	(E)	41,885
Contractual Serv.-Engineering	300	0		300
Contractual Serv.-Accounting	25,402	0		25,402
Transportation Expenses	19,388	0		19,388
General Liability Insurance		0	(F)	0
Vehicle Insurance	76,965	(59,793)	(G)	17,172
Workers' Compensation Ins.		6,776	(H)	6,776
Amortization Expense	1,095	0		1,095
Miscellaneous Expenses	<u>17,205</u>	<u>(12,370)</u>	(I)	<u>4,835</u>
Total Water Expenses	\$ 644,682	\$ (107,314)		\$ 537,368
Depreciation Expense	101,840	0		101,840
Taxes Other Than Income	<u>11,670</u>	0		<u>11,670</u>
Total Operating Expenses	758,192	\$ (107,314)		<u>650,878</u>
Operating Income	\$ (44,246)	\$ 169,344		\$ 125,098
Interest Income	61	0		61
Interest Expense	<u>63,282</u>	0		<u>63,282</u>
Net Income	<u>\$ (107,467)</u>	<u>\$ 169,344</u>		<u>\$ 61,877</u>

APPENDIX B
STAFF REPORT, CASE NO. 2011-00441
PRO FORMA ADJUSTMENTS

A. Normalized Operating Revenues-Residential

Revenues have been normalized using the end-of-period customer level and the current rate. The adjustment reflects the results of Commission Staff's billing analysis and the current rate schedule. On June 15, 2010, the Commission, in Case No. 2010-00018, adjusted North Manchester's rates.

B. Pensions and Benefits-Health Insurance

Test-period health insurance expense totals \$35,484. A review of 2011 invoices shows that the health insurance premium increased to \$3,146 per month, or \$37,752 annually. (\$3,146 x 12). The utility reimburses an employee \$561.16 monthly, or \$6,734 annually, for his health insurance costs because he is covered under his spouse's health insurance policy. This amount represents North Manchester's contribution towards the cost for health insurance for each employee and is paid directly to the employee. This payment brings the total health insurance expense to \$44,486 annually.

C. Purchased Water Expense

807 KAR 5:066, Section 6(3) provides that "for rate making purposes a utility's unaccounted-for water loss shall not exceed fifteen (15) percent of total water produced and purchased, excluding water used by a utility in its own operations." North Manchester reported unaccounted-for water of 35.858 per cent for the test period. The cost of all unaccounted-for water in excess of 15 percent of total water purchased is unreasonable and should be disallowed. Commission Staff recommends that purchased water expense be decreased by \$73,230.

Unaccounted for Water Loss Percentage

Water Produced/Purchased	185,298,500
Water Sales - Staff's Billing Analysis	110,585,010
Water Treatment Plant	0
System Flushing	4,450,000
Fire Department	3,820,000
Other	0
Total Water Sold and Used	118,855,010
Unaccounted for Water Loss - Gallons	66,443,490
Percentage of Unaccounted for Water Loss	35.858%
Percentage Water Loss in Excess of 15 Percent	20.858%

Determination of Pro Forma Purchased Water

Pro Forma Water Sales	110,585,010
Add: System Flushing, Fire Department, and Other	8,270,000
Subtotal	118,855,010
Divided by: 15% Line Loss Reciprocal	85.00%
Allowable Purchases/Production	139,829,424

Purchased Water Cost per 1,000 Gal

Allowable Purchases	139,829.424
Multiplied by: Water Rate per 1,000 Gallons	\$ 1.500
Pro Forma Purchased Water Expense	\$ 209,744
Less: Actual Test-period Expense	272,924
Pro Forma Adjustment - Nonrevenue Water	\$ (63,180)
Less: Penalties	(10,050)
Total Adjustment	\$ (73,230)

D. Purchased Power Expense

Test-period Purchased Power was \$53,843. A review of test period invoices indicated that North Manchester incorrectly recorded \$25,553 of Purchased Water expenses as Purchased Power expenses. This amount was reclassified. No corresponding adjustment to Purchased Water is necessary as the pro forma amount of this expense reflects the total allowable amount for this account. (See Adjustment C above.)

E. Materials and Supplies

North Manchester's Materials and Supplies account should be increased by \$12,370 to reflect the reclassification of certain expenses in the Miscellaneous Expense account. (See Adjustment I.) This adjustment results in test period expense of \$41,885.

F. General Liability Insurance.

Commission Staff reclassified \$2,331 of Vehicle Insurance to this account to reflect the cost of a general liability insurance policy that incorrectly recorded to Vehicle Insurance account. This policy, however, will expire on August 26, 2012. James Arnett, of Mountain Valley Insurance Staff, has advised Commission Staff that upon its expiration this policy will be rolled into the policy discussed below in Adjustment G at virtually no additional cost. Accordingly, Commission Staff has eliminated the test-period expense.

G. Vehicle Insurance

North Manchester recorded all insurance expenses in the Vehicle Insurance account resulting in a test-period balance of \$76,965. Commission Staff has reclassified \$44,486 as Health Insurance (Adjustment B). Invoices reflect an annual expense for Workers' Compensation insurance of \$6,776 and \$2,331 for general liability insurance. These amounts were incorrectly recorded in the Vehicle Insurance account. Commission Staff has reclassified them to their proper account. North Manchester now uses a different insurance agency, U.S. Specialty Insurance Company, which results in a decrease in premium of \$6,200. These changes and reclassifications result in an adjustment to decrease Vehicle Insurance by \$59,793, leaving an amount of \$17,172 for vehicle insurance.

H. Workers' Compensation Insurance.

A review of North Manchester's invoices showed its Workers' Compensation Insurance totaled \$6,776. This amount was reclassified from the Vehicle Insurance account.

I. Miscellaneous Expense.

North Manchester recorded several expenses in its Miscellaneous Expense account totaling \$12,370 that should have been included as materials and supplies. Commission Staff has reclassified these expenses to that account.

APPENDIX C
STAFF REPORT, CASE NO. 2011-00441
DEBT SERVICE AND REVENUE REQUIREMENT

3 Year Average Debt Service			
<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	99,831	\$ 51,151	\$150,982
2013	102,816	48,166	150,982
2014	<u>105,890</u>	<u>45,092</u>	<u>150,982</u>
Total	<u>308,537</u>	<u>\$144,409</u>	<u>\$ 452,946</u>
3 year average			\$ 150,982

Revenue Requirement Calculation	
Adjusted Operating Expenses	\$650,878
Debt Service	150,982
.20 Coverage	<u>30,196</u>
Revenue Requirement	\$832,056
Other Operating Revenue	(893)
Normalized Revenue	<u>(775,083)</u>
Increase	<u>\$ 56,080</u>

APPENDIX D
STAFF REPORT, CASE NO. 2011-00441
RECOMMENDED RATES

5/8-Inch x 3/4-Inch Meter

First	2,000 gallons	\$ 19.80 minimum bill
All Over	2,000 gallons	\$ 5.32 per 1,000 gallons

1-Inch Meter

First	5,000 gallons	\$ 35.71 minimum bill
All Over	5,000 gallons	\$ 5.32 per 1,000 gallons

2-Inch Meter

First	15,000 gallons	\$ 88.79 minimum bill
All Over	15,000 gallons	\$ 5.32 per 1,000 gallons

3-Meter

First	30,000 gallons	\$ 168.42 minimum bill
All Over	30,000 gallons	\$ 5.32 per 1,000 gallons

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