COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

CONTRACT FILING OF CHRISTIAN COUNTY WATER DISTRICT TO PURCHASE WATER FROM BARKLEY LAKE WATER DISTRICT	)))	CASE NO. 2006-00068

ORDER

On November 10, 2005, Christian County Water District ("Christian District"), on behalf of Barkley Lake Water District ("Barkley Lake District"), submitted a special contract for Barkley Lake District's provision of wholesale water service to Christian District. After reviewing the proposed contract, the Commission on February 24, 2006 initiated this proceeding to investigate the reasonableness of the proposed wholesale rate.

The Commission is concerned that the proposed wholesale contract of $1.65 per 1,000 gallons of water is sufficient to recover Barkley Lake District's production and transmission costs. The lowest step in Barkley Lake District's current rate schedule is $3.12 per 1,000 gallons. Based upon its annual report to the Commission for the calendar year ending December 31, 2005, Barkley Lake District's average cost of production was $1.95 per 1,000 gallons.[1] When depreciation expense associated with production facilities and debt service are considered, this cost is $3.18 per 1,000

[1] Annual Report of Barkley Lake Water District to the Public Service Commission of Kentucky for the Year Ending December 31, 2005 at 28 – 29. The average cost of production is calculated as follows:

$$\frac{\text{Supply-O\& M Expense + Water Treatment-O\&M Expense}}{\text{Total Water Sales}} = \frac{\$212{,}300 + \$293{,}203}{259{,}530{,}000 \text{ gallons}}$$

gallons.[2] If the cost associated with transmission of the water to Christian District is then added, Barkley Lake District's average cost of water sold to Christian District is approximately $3.28 per 1,000 gallons.[3]

Barkley Lake District argues that the proposed wholesale rate does exceed its incremental cost of production and will generate additional revenues that may be used to offset or delay rate increases for its retail customers. It notes that its debt service costs and production costs such as employee salaries will not increase even as production is increased to meet Christian District's demand.

The Commission agrees that the proposed wholesale rate exceeds the water district's incremental cost of production and is likely to produce additional revenues. If the sales to Christian District extend over a significant period of time without any rate revision or rebalancing, however, retail customers will be unfairly required to bear a sizable and unreasonable portion of the water district's fixed costs. Accordingly, we find that, while the proposed wholesale rate should be allowed to become effective, Barkley Lake District should be required to rebalance its rates periodically to ensure that costs are properly assigned to all customer groups.

Barkley Lake District should apply to the Commission, no later than July 1, 2008, for a rate adjustment to reflect its current operating conditions. Its application for rate adjustment should include a cost-of-service study that addresses the costs associated

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[2] Barkley Lake District reports depreciation expense of $29,876 for its water production facilities and debt service payments of $289,098. See Barkley Lake District's Response to Commission Staff's Interrogatories and Requests for Production of Document, Item 6; Annual Report of Barkley Lake Water District to the Public Service Commission of Kentucky for the Year Ending December 31, 2005 at 23.

[3] Barkley Lake District reports the cost of transporting finished water from its water treatment plant to the point of delivery to Christian District as $0.10 per 1,000 gallons. Barkley Lake District's Response to the Commission's Order of February 24, 2006 at Item 7.

with any wholesale water sales to Christian District or other water suppliers and their proper allocation.

As KRS 278.023 permits Barkley Lake District to adjust its rates with very limited Commission review where such rates are specified in an agreement with the U.S. Department of Agriculture for the financing of any construction projection, the Commission recommends to the U.S. Department of Agriculture that it review and carefully consider the allocation of fixed costs to wholesale customers before mandating any new rates for Barkley Lake District.

IT IS THEREFORE ORDERED that:

1. The proposed contract between Barkley Lake District and Christian District is approved.

2. Barkley Lake District shall, no later than July 1, 2008, apply to the Commission for an adjustment of its rates for water service. In its application Barkley Lake District shall include a cost-of-service study that is consistent with the current AWWA Manual M1 guidelines[4] and addresses the costs associated with any wholesale water sales to Christian District or other water suppliers and their proper allocation.

3. The Executive Director shall serve a copy of this Order upon the State Director of Rural Development.

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[4] American Water Works Association, Principles of Water Rates, Fees, and Charges AWWA Manual M1 (5th ed. 2000).

Done at Frankfort, Kentucky, this 7th day of September, 2006.

By the Commission

ATTEST:

Executive Director