

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF THE ALTON WATER)
DISTRICT, A WATER DISTRICT ORGANIZED)
PURSUANT TO CHAPTER 74 OF THE KENTUCKY)
REVISED STATUTES, OF ANDERSON COUNTY,)
KENTUCKY, FOR (1) A CERTIFICATE OF)
PUBLIC CONVENIENCE AND NECESSITY,)
AUTHORIZING AND PERMITTING SAID WATER) CASE NO. 9274
DISTRICT TO CONSTRUCT A SEWAGE SYSTEM;)
(2) APPROVAL OF THE PROPOSED PLAN OF)
FINANCING OF SAID PROJECT; AND (3))
APPROVAL OF THE SEWER RATES PROPOSED)
TO BE CHARGED BY THE DISTRICT TO THE)
CUSTOMERS OF THE DISTRICT)

O R D E R

The Alton Water District ("Alton") by application filed February 15, 1986, and revised during the proceedings in this matter, is seeking the establishment of initial sewage rates, authorization to construct a \$2,387,500 sewage collection system, and approval of its financing for the proposed project. Alton's project financing includes \$70,500 from applicants for service in the proposed project area, a grant of \$1,816,000 from the Environmental Protection Agency ("EPA"), a grant of \$152,000 from the Farmers Home Administration ("FmHA"), a loan of \$235,000 from FmHA at an approved annual interest rate of 11 3/8 percent and a loan of \$114,000 from the FmHA at an approved annual interest rate of 8 3/8 percent.

Alton will issue sewer revenue bonds as security for the FmHA loans. The repayment period for the loan will be 40 years. The proposed improvements will provide sewage service to about 254 customers.

Plans and specifications for these improvements as prepared by GRW Engineers, Inc., of Lexington, Kentucky, ("Engineer") have been approved by the Division of Water of the Natural Resources and Environmental Protection Cabinet.

A hearing was held in the offices of the Public Service Commission, Frankfort, Kentucky, on February 24, 1986. Mr. Charles T. Weaver, president of Kentucky River Development Corporation intervened in this case to request sewage service for the proposed Nottingham Mobile Home Park ("Nottingham").

SEWAGE SERVICE TO NOTTINGHAM

Mr. Weaver has requested Alton to provide sewage service to Nottingham, which could ultimately have 300-400 connections in northern Anderson County. Mr. Weaver has proposed the construction of a collection system in Nottingham and a force main to connect Nottingham's collection system to Alton's proposed sewage system.

Alton has denied a connection to its proposed sewage system based on the advice of its attorney, Thomas M. Jones, and its Engineer. This advice was based on the policies of the funding agencies for the proposed construction of prohibiting extensions to speculative ventures, the possibility of exceeding the contract limits for the treatment of sewage with the City of Lawrenceburg, and engineering design concerns.

Alton's Engineer testified that the proposed sewage system's physical layout prohibited connecting Nottingham onto Alton's system at the nearest point. The nearest portion of Alton's system to Nottingham is a vacuum collection system. The Engineer also testified that it is not appropriate to connect a force main into a vacuum system although the converse is acceptable engineering practice. At the very least, Nottingham's force main would have to be constructed to Alton's proposed primary force main which is several miles from Nottingham. In addition, Alton's Engineer testified that the proposed system was not designed for an increase in customers of this magnitude. As such it would seem to follow that a major re-design of the current construction project would be required to accommodate the sewage from Nottingham.

While the Commission is interested in as many customers as possible receiving sewage through Alton's proposed system, the issues as discussed above prevent any immediate resolution of this problem. Due to these facts, the Commission is of the opinion that it is in the best interest of the affected parties to proceed with the construction as originally proposed, without the proposed Nottingham development. This by no means should prevent the Kentucky River Development Corporation from pursuing sewage service by other means or from other sources.

REVENUE REQUIREMENTS

On February 3, 1986, Alton filed a revised Engineering Report containing estimated operation and maintenance expenses. The Commission is of the opinion that the estimated expenses are

generally fair and reasonable; however, for the purposes of determining revenue requirements, the Commission has made the following modifications to reflect the most current information available in the record:

Debt Repayment

Alton projected debt service for the first year of \$32,500 on the total \$349,000 bond issuances.¹ Alton entered into an agreement with FmHA so that the interest rates on the loans would be the lower of the rate at the time of loan approval or the rate at the time of closing. Alton assumed a 9 percent averaged interest rate on the bond issuances based upon a projection of the interest rate at the proposed time of closing. The Commission is of the opinion that for the purpose of determining revenue requirements herein, it is appropriate to use the average debt service for the first 3 years of operations calculated using Alton's projected averaged interest rate of 9 percent. This results in an annual debt service requirement of \$31,743.

Depreciation Expense

Alton calculated the depreciation expense on noncontributed property to be \$6,980. However, this expense was not included in the statement of anticipated operating expenses because Alton stated that this expense is not physically experienced.² For the purposes of determining revenue requirements, the Commission has

¹ Revised Engineering Report filed February 3, 1986, p. 17.

² Response to Commission's Order dated February 5, 1986, Item No. 1.

allowed a depreciation expense of \$6,980 in order for the ratepayers to pay only for the plant in which the utility has made an investment.

Alton proposed rates to produce gross annual operating revenues of \$85,594. This revenue requirement is based on a proposed debt service coverage ("DSC") of 1.2X. The Commission finds that a 1.2X DSC is a fair, just and reasonable method for determining revenue requirements in this instance because it will result in gross annual operating revenue sufficient to allow Alton to pay its operating expenses and provide a reasonable surplus for equity growth. Therefore, the Commission accepts Alton's proposed use of a 1.2X DSC for the purposes of determining revenue requirements herein. Using a DSC of 1.2X, plus operating expenses, the Commission finds Alton's revenue requirement to be as follows:

| | |
|------------------------|-----------------|
| Operating Expenses | \$45,600 |
| Allowable Depreciation | 6,980 |
| Debt Service | 31,743 |
| Twenty Percent DSC | <u>6,349</u> |
| Revenue Requirement | <u>\$90,672</u> |

The Commission is of the opinion and finds that the revenues requested by Alton will be sufficient to pay the Sewer Division's operating expenses, service its debt and provide a reasonable surplus for equity growth and should, therefore, be approved.

RATE DESIGN

In its application, Alton proposed a declining block rate schedule, and indicated it was charging each new sewer customer a \$250 tap-on fee.

Alton's proposed rate schedule consists of a two step design. Each residential sewer bill will be based on each customer's water usage. For industrial customers, Alton has proposed to meter the sewage as it enters the system so that each industrial customer pays only for the collection and treatment of that amount of sewage and not for water lost.

The Commission is of the opinion that the rates and charges produce the revenues requested by Alton, and therefore should be approved for services rendered. Furthermore, the rates shown in Appendix A are the fair just and reasonable rates to be charged.

FINDINGS AND ORDERS

The Commission, after consideration of the application and evidence of record and being advised, is of the opinion and finds that:

1. Public convenience and necessity require that the construction proposed in the application and record be performed and that a certificate of public convenience and necessity be granted.
2. The proposed construction includes a sewage collection system to provide sewage service for about 254 customers.
3. The low bids received for the proposed improvements totaled \$1,858,436, which will require about \$2,387,500 in project

funding after allowances are made for fees, contingencies, other indirect costs and additional construction being considered.

4. Alton should obtain approval from the Commission prior to performing any additional construction not expressly certificated by this Order.

5. Any deviations from the construction herein approved which could adversely affect service to any customer should be subject to the prior approval of this Commission.

6. The proposed borrowing of \$349,000 is for lawful objects within the corporate purposes of Alton, is necessary and appropriate for and consistent with the proper performance of services to the public by Alton, and will not impair its ability to perform these services.

7. The financing secured by Alton for this project will be needed to pay for the work herein approved. Alton's financing plan should, therefore, be approved.

8. Alton should file with the Commission duly verified documentation which shows the total costs of construction including all capitalized costs (engineering, legal, administrative, etc.) within 60 days of the date that construction is substantially completed. Said construction costs should be classified into appropriate plant accounts in accordance with the Uniform System of Accounts for Sewer Utilities prescribed by this Commission.

9. Alton's contract with its Engineer should require the provision of full-time resident inspection under the general supervision of a professional engineer with a Kentucky

registration in civil or mechanical engineering. The supervision and inspection should insure that the construction work is done in accordance with the contract plans and specifications and in conformance with the best practices of the construction trades involved in the project.

10. Alton should require the Engineer to furnish a copy of the record plans and a signed statement that the construction has been satisfactorily completed in accordance with the contract plans and specifications within 60 days of the date of substantial completion of this construction.

11. A valid third party beneficiary agreement is normally required from sewage utilities to insure the continuity of sewage service pursuant to 807 KAR 5:071. Alton is a utility formed under KRS Chapter 74 and under the jurisdiction of the Commission. Sufficient evidence of financial integrity as will insure the continued operation of sewage service has been provided by virtue of the past history and current operations of Alton. For these reasons, the Commission will waive its requirement of a third party beneficiary agreement in this case.

12. Alton should file with the Commission a copy of all contractual agreements for the provision of services or the purchase of services which are subject to the approval of this Commission.

13. The risks to be borne by Alton during the initial operating years of its sewage facilities require the establishment of a financial reserve against these risks. Alton should, therefore, set aside \$70,500 of its applicant contributions in

accordance with the FmHA letter of conditions for this project. These funds should be utilized to supplement the cost of utility operations and maintenance during the first 5 to 10 years of operations.

14. The revenues requested by Alton will be sufficient to pay the Sewer Division's operating expenses, service its debt and provide a reasonable surplus for equity growth and should, therefore, be approved.

15. The rates in Appendix A are fair, just and reasonable rates for Alton and will produce annual sewer revenue of approximately \$85,594.

IT IS THEREFORE ORDERED that:

1. Alton be and it hereby is granted a certificate of public convenience and necessity to proceed with the construction of the sewage collection and disposal system set forth in the plans and specifications of record hereby approved.

2. Alton shall comply with all matters set out in Findings 4 and 5 and Findings 7 through 13 as if the same were individually so ordered.

3. Alton's plan of funding this project consisting of contributions in the amount of \$2,038,500, a loan from the FmHA in the amount of \$235,000 with an approved interest rate of 11 3/8 percent and a loan from FmHA at an approved annual interest rate of 8 3/8 percent is hereby approved.

4. Alton shall file with the Commission the FmHA notification of the interest rate at the time of closing of the loan and

shall provide copies of all correspondence from and to FmHA concerning this notification within 30 days of the closing date.

5. Alton shall file a statement of the interest rate accepted from FmHA within 30 days of the date of closing.

6. If Alton accepts an interest rate different from the rate approved herein, it shall file amended pages to its bond resolution and an amended amortization schedule.

7. If Alton is eligible but does not take advantage of a lower interest rate at the time of closing, it shall fully document why the lower rate was not accepted showing an analysis of the higher costs associated with the loan over its life.

8. The rates in Appendix A be and they hereby are approved for service rendered by Alton on and after the date of this Order.

9. Within 30 days from the date of this Order Alton shall file with the Commission a tariff sheet setting out the rates approved herein.

Nothing contained herein shall be deemed a warranty of the Commonwealth of Kentucky, or any agency thereof, of the financing herein authorized.

Done at Frankfort, Kentucky, this 2nd day of April, 1986.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 9274 DATED April 2, 1986.

The following rates and charges are prescribed for the customers in the area served by the Alton Water and Sewer District. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

Monthly Sewer Charge

Rate

First 2,000 gallons

\$8.70 Minimum Bill

Over 2,000 gallons

4.35 per 1,000 gallons

Tap-On Service Connection Fee

Per customer

\$250.00