

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF EAST DAVIESS)	
COUNTY WATER ASSOCIATION, INC. TO)	
REDUCE WATER RATES TO RESIDENTIAL)	CASE NO. 89-377
CUSTOMERS IN SOUTH HANCOCK COUNTY,)	
KENTUCKY)	

O R D E R

On December 22, 1989, East Daviess County Water Association, Inc. ("East Daviess") filed its application seeking approval of the following: (1) an initial rate reduction for those customers formerly served by Hancock County Public Improvement Corporation ("HCPIC") and (2) a three phase rate reduction which would be implemented without further Commission approval when HCPIC's customer base reached certain pre-established levels. HCPIC's initial rate decrease would result in a reduction in annual operating revenues of \$25,944, a decrease of approximately 26 percent below test-period revenues of \$99,393.

The Commission Staff ("Staff") conducted a field review of East Daviess' test-period financial records for HCPIC and on April 18, 1990 issued its report. In that report, Staff recommended that East Daviess' rate reduction request and three phase rate reduction plan be denied.

On May 3, 1990, East Daviess filed a request for an informal conference and an extension of time in which to file its comments to the Staff Report. On July 13, 1990, an informal conference was

held at the Commission's offices in Frankfort, Kentucky. Following that meeting, East Daviess filed its response to the Staff Report on April 11, 1990. There were no intervenors and a hearing was not held in this proceeding.

Commentary

In 1976 East Daviess expanded into southern Hancock County, becoming the first public water system to service that area. Other Hancock County residents requested service; however, further expansion would have required East Daviess to install additional water storage tanks and booster pump stations. The additional capital cost of further expansion coupled with Hancock County's sparse population made it impossible for East Daviess to obtain the required financing.

In an attempt to obtain water service for this area, Hancock County through the HCPIC obtained various grants and a loan from the Farmers Home Administration ("FmHA"). Subsequently, Hancock County and East Daviess entered into an agreement, whereby HCPIC became a "conduit" for the necessary financing and East Daviess operated and managed the new water system.

In Case No. 9931,¹ the Commission approved HCPIC's proposed construction, contingent upon its management agreement with East

¹ Case No. 9931, The Application of Hancock County Public Improvement Corporation and the County of Hancock, (1) For a Certificate that Public Convenience and Necessity Requires the Construction of Water Distribution Facilities In a Portion of Hancock County; and (2) Seeking Approval of the Issuance of Certain Securities; and (3) For an Order Authorizing Proposed Water Service Rates and Charges, Order entered October 2, 1987.

Daviess. The Commission stated that any change in HCPIC's management arrangement would require prior Commission approval and it strongly urged Hancock County to transfer HCPIC to East Daviess as soon as it could be appropriately arranged.

On May 12, 1989, HCPIC and East Daviess entered into an agreement, whereby East Daviess agreed to purchase HCPIC and simultaneously assume HCPIC's indebtedness, subject to prior Commission approval. In Case No. 89-139,² the Commission approved the transfer of HCPIC to East Daviess and authorized East Daviess to assume HCPIC's outstanding indebtedness and to adopt as its own HCPIC's rates, rules, classifications, and regulations.

On September 21, 1987, the FmHA informed East Daviess that its outstanding FmHA loans were purchased by the General Electric Credit Corporation ("GECC").³ Accordingly, GECC holds the mortgage on East Daviess' assets while the FmHA maintained the mortgage on the assets of HCPIC. East Daviess' and HCPIC's loan agreements do not recognize the merger approved by this Commission. To abide by its lenders' requirements, East Daviess' and HCPIC's financial records and rates are maintained separately, as if the merger had not taken place.

² Case No. 89-139, The Application of Hancock County Public Improvement Corporation and Hancock County, Kentucky for Approval of an Agreement of Sale Providing for the Purchase by the East Daviess County Water Association, Inc. from Hancock County Public Improvement Corporation of the Corporation's Existing Waterworks Distribution System, Order entered June 30, 1989.

³ Report on Examination of Financial Statements of East Daviess County Water Association, Inc., for the Years Ended December 31, 1987 and December 31, 1986, Page 9.

Revenue Requirements Determination

In its response to the Staff Report, East Daviess took exception to Staff's recommendation to deny its proposed rate reduction. East Daviess proposed the following adjustments to the Staff Report: (1) reduce depreciation expense to \$8,077; (2) eliminate electric and customer billing expense of \$2,817; and (3) reduce its debt service coverage to 1.05x.

In its calculation of depreciation expense of \$8,077, East Daviess excluded some plant classifications, and extended the depreciation lives of others. The Commission does not agree with the methodology East Daviess used to calculate depreciation expense; however, the proposed level of this expense has been allowed for rate-making purposes.

East Daviess proposed an adjustment to eliminate electric and customer billing expense of \$2,817 based on its interpretation of its purchased water contract. The purchased water contract between East Daviess and HCPIC contained the following language: "the seller (East Daviess) assumed the obligation and responsibility to operate, maintain and repair the water lines, pumps, tanks, meters, and necessary machinery and equipment." Therefore, East Daviess contends that HCPIC's electric and customer billing expense is accounted for in purchased water expense. The Commission finds that East Daviess' interpretation of the contract is correct and its adjustment should be accepted.

East Daviess contends that a DSC of 1.19x for its HCPIC customers will result in continued system inequities and that a DSC of 1.05x is appropriate. The DSC factor for the customers

outside the HCPIC system is substantially less than Staff's recommended 1.19x. East Daviess stated that the inconsistent DSC's have resulted in its HCPIC customers subsidizing the remainder of its system.

East Daviess' long-range goal is to implement a single rate structure for all of its customers. This goal cannot be reached until its FmHA debt is retired or merged with its GECC indebtedness. Therefore, East Daviess is in the process of developing an accounting system that will directly allocate revenues and expenses to each operational division. After its accounting system has been in operation for one year, East Daviess will seek rates that are equitable and that will eliminate possible cross subsidization. East Daviess has requested that its rate reduction be accepted for the interim.

The Commission finds that East Daviess' request to implement its rate reduction on an interim basis is reasonable. The adjustments accepted herein have increased East Daviess' income available for debt service by \$19,596. In spite of a revenue reduction of \$25,994, East Daviess will still have a positive cash flow of \$10,031.⁴ Therefore, the Commission will grant East Daviess the requested rate reduction on an interim basis. In

4	Net Operating Income - Staff Report	\$44,676
	Add: Adjustments Recommended Herein	19,596
	Depreciation Expense	8,077
	Interest Income	1,341
	Subtotal	<u>\$73,690</u>
	Less: Proposed Reduction	25,944
	Debt Service	<u>37,715</u>
	Cash Flow	<u>\$10,031</u>

doing so, the Commission stresses that this is an interim measure and that within 16 months from the date of this Order, East Daviess will file for revised rates for all of its customers based on its new accounting system. The Commission also advises East Daviess to closely review its financial position during this interim period and take such appropriate action as it deems necessary.

SUMMARY

After consideration of the evidence of record and being otherwise sufficiently advised, the Commission finds that:

1. The rates proposed by East Daviess for HCPIC are the fair, just, and reasonable rates for East Daviess to charge in the HCPIC service area on an interim basis.

2. East Daviess will file for permanent rates for its entire system within 16 months from the date of this Order.

IT IS THEREFORE ORDERED that:

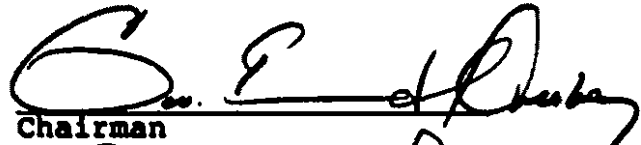
1. The rates contained in Appendix A, which is attached hereto and incorporated herein, are approved on an interim basis for service rendered on and after the date of this Order.

2. East Daviess shall request permanent rates for its entire system within 16 months from the date of this Order.

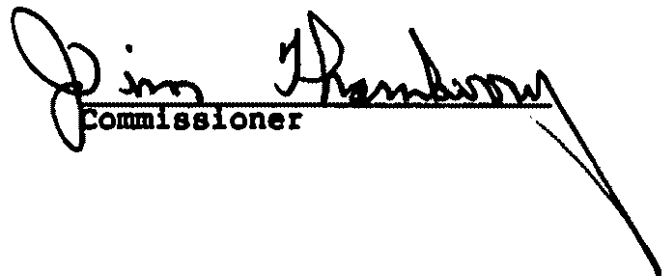
3. Within 30 days from the date of this Order, East Daviess shall file with the Commission its revised tariff sheets setting out the rates approved herein on an interim basis.

Done at Frankfort, Kentucky, this 19th day of October, 1990.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:


Executive Director

APPENDIX A

**APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 89-377 DATED 10/19/90**

The following rates and charges are prescribed for customers of East Daviess Water Association formerly served by Hancock County Public Improvement Corporation. 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.

Rate Increments

First 2,000 Gallons
Next 4,000 Gallons
Next 44,000 Gallons
Over 50,000 Gallons

Monthly Rates

\$16.50 Minimum Bill
5.00 per 1,000 Gallons
2.26 per 1,000 Gallons
2.26 per 1,000 Gallons