COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION AND NOTICE OF CAMPBELL COUNTY KENTUCKY WATER DISTRICT TO ADJUST RATES EFFECTIVE MAY 1, 1991	)))	CASE NO. 91-039

O R D E R

On March 22, 1991, Campbell County Kentucky Water District ("Campbell District") applied for authority to increase its rates for service rendered after May 1, 1991. The proposed rates would increase annual revenues by $533,500,[1] an increase of approximately 11 percent over normalized test-year revenues. This Order grants an increase in annual revenues of $441,047 or 9 percent.

The Commission suspended the proposed rate increases until October 1, 1991 to investigate their reasonableness. The cities of Highland Heights ("Highland Heights") and Newport ("Newport") were permitted to intervene in this matter. A hearing for the purpose of cross-examination of the witnesses of Campbell District and the intervenors was held on August 1, 1991.

COMMENTARY

Campbell District is a water district, organized in 1955 pursuant to KRS Chapter 74, which distributes and sells water to

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1 Application of Campbell District, at 2.

approximately 16,800 retail customers in Campbell County, Kentucky. It also provides wholesale water to Highland Heights, Pendleton County Water District, and Kenton County Water District No. 1 ("Kenton District"). Lacking its own water production facilities, Campbell District purchases its water supply from Newport and Kenton District.

TEST PERIOD

Campbell District proposed and the Commission has accepted the 12-month period ending December 31, 1990 as the test period for determining the reasonableness of the proposed rates. In using this historic test period, the Commission has given full consideration to appropriate known and measurable changes.

REVENUES AND EXPENSES

Campbell District reported test-period income before debt service of $1,220,396.[2] It has proposed several adjustments to test-year operations to normalize current operating conditions. The Commission finds that these adjustments, which result in a net reduction to income of $411,444, are reasonable and in accordance with accepted rate-making principles, save for those noted below.

Revenue from Water Sales

Campbell District reported test-year revenues from water sales of $4,400,222 and proposed a normalized level of revenues from water sales of $4,664,311. The Commission finds that this proposed level should be adjusted by $5,296 to reflect an increase

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2 Transcript of Evidence ("T.E."), Campbell District Exhibit F.

of $4,505 in revenue from metered water sales, a decrease of $695 in revenue from wholesale customers, and the inclusion of miscellaneous water sales of $1,486. The total increase in Campbell District's test-year revenues from water sales is $269,385.

Other Operating Revenues

Campbell District reported other operating revenues of $75,008 for the test period which included rental income from water property of $11,794. This rental income was generated through the rental of water storage tank space for antennas.[3] Campbell District subsequently advised the Commission that total revenues generated by antenna rental space during the test period were $22,414, an increase of $10,620 over the previously reported level.[4]

Purchased Water Expense

Campbell District proposed to increase purchased water expense by $218,651 to normalize test-period purchases and to cover increased purchases due to customer growth. It proposed a purchase level of 2,008,976,226 gallons.

Campbell District's proposed level of purchased water expense of $1,340,991 assumes that Campbell District will purchase 14 percent of its total water requirements from Kenton District at a

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3 Campbell District's Response to the Commission's Order of May 9, 1991, Item 32.

4 Letter from Ronald J. Barrow to Lee M. MacCracken (August 9, 1991) (providing information requested at August 1, 1991 Hearing), Item 7.

cost of 77.5 cents per 1,000 gallons and the remaining 86 percent from Newport at 65 cents per 1,000 gallons. During the test year, Campbell District purchased only 3 percent of its total water requirements from Kenton District.

Campbell District offers two reasons for its proposed adjustment. First, it contends that the Commission in Case No. 89-029,[5] ordered it to purchase 14 percent of its total water requirement from Kenton District.[6] It also contends that, but for problems with a pumping station, Campbell District would have purchased that amount from Kenton District in the test year.[7]

The record fails to support these arguments. In Case No. 89-029, the Commission did not specify the amount of water which Campbell District was to purchase from either supplier, but stated that Campbell District's rates should be based on the amount of water which Newport could supply.[8] The rates established in that case were based upon Campbell District's level of purchase from Newport during the test period - the 1988 calendar year.

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5 Case No. 89-029, Application and Notice of Campbell County Kentucky Water District (A) To Issue Revenue Bonds in the Approximate Principal Amount of $5,535,000 (B) To Construct Additional Plant Facilities of Approximately $4,523,000 (C) Notice of Adjustment of Rates Effective May 1, 1989 (D) Submission of Long-term Water Supply Contract.

6 T.E. at 58.

7 T.E. at 63; Campbell District's Application, Exhibit E, at 6.

8 Case No. 89-029, Order dated January 31, 1990 at 20 ("...Campbell District's purchased water expense should be limited to Newport's proffered rate of 52 cents per 1,000 gallons for that portion of its purchased water which would have been supplied by Newport had a long-term water supply contract been executed.").

The proposed 86/14 ratio, furthermore, does not reflect normal operating conditions. Only once in the last 5 years has Campbell District purchased 14 percent or more of its total water requirements from Kenton District. Campbell District officials concede that the 1988 year was a drought year and involved "emergency demands."[9] It was not reflective of Campbell District's normal operations.

Despite the fact that Campbell District officials contend that the water district intends to purchase 14 percent of its water requirements from Kenton District - an amount 5 times greater than that purchased in 1990 - no notice of this increase has been given to nor discussion about this increase held with Kenton District officials.[10] This lack of planning suggests that Campbell District's proposed purchases are tentative and uncertain.

The record fails to support Campbell District's contention that pumping station problems prevented the purchase of 14 percent of its water requirements from Kenton District. Campbell District cited no change in the pumping station's condition over the last 5 years. This same station enabled Campbell District to purchase 14 percent of its water requirements in 1988. No Campbell District official testified that this pumping station was not capable of pumping this volume of water again.

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9 T.E. at 61; Campbell District's Response to the Commission's Order of May 9, 1991, Item 3.

10 T.E. at 66; Campbell District's Response to the Commission's Order of May 9, 1991, Item 5.

In reviewing Campbell District's water purchase practices for the 1988-1990 period, the Commission finds that neither the 86/14 ratio nor the test-year ratio are reflective of Campbell District's normal operations. Given the fluctuations in Campbell District's level of purchases from its two suppliers, the Commission finds that a ratio based upon a 5 year average of Campbell District's water purchases will more accurately reflect its normal operations. Accordingly, the Commission has calculated Campbell District's purchased water expense upon the assumption that 8 percent of Campbell District's total water requirement will be purchased from Kenton District and the remainder from Newport.[11]

Any calculation of Campbell District's purchased water expense must consider the Commission's findings in Case Nos. 89-014[12] and 89-029. In these cases, the Commission found that

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	Kenton	Newport
1986	8.58%	91.42%
1987	5.22%	94.78%
1988	10.94%	89.06%
1989	11.33%	88.67%
1990	2.35%	97.65%
	38.42%	461.58%
	÷ 5 yrs.	÷ 5 yrs.
5-Year Average	7.68%	92.32%

See Campbell District's Response to the Commission's Order of May 9, 1991, Item 29.

12 Case No. 89-014, City of Newport v. Campbell County Kentucky Water District and Kenton County Water District No. 1 and Charles Atkins and Steven J. Franzen v. Campbell County Kentucky Water District.

Campbell District had not acted prudently, reasonably, and in the best interests of its customers in refusing to negotiate a long-term water supply contract with Newport and in entering an exclusive water supply contract with Kenton District. We further found that the level of Campbell District's purchased water expense should be based, in part, upon the terms of Newport's proffered contract. Accordingly, Campbell District's purchased water expense for purchases from Newport was based on a rate of 52 cents per 1,000 gallons.

Notwithstanding our actions in Case Nos. 89-014 and 89-029, the Commission finds that the level of Campbell District's purchased water expense should be calculated using Newport's current rate of 65 cents per 1,000 gallons. The evidence of record in this case shows no other rate at which Newport has offered to provide water. Newport officials declined to specify a different contract rate and instead stated that any contract rate would be dependent on several factors. In the absence of a specific rate at which Newport is ready and willing to provide water under a long-term water supply contract, the Commission's only course is to use Newport's present rate.

The Commission has calculated Campbell District's total gallonage requirement to be 1,980,775,116. Based upon the purchase of 8 percent of this volume from Kenton District at 77.5 cents per 1,000 gallons and the remainder from Newport at the rate of 65 cents per 1,000 gallons, purchased water expense has been included at a level of $1,307,312, an increase of $184,972 over test-period expense.

Pension Expense

During the test year, Campbell District elected to participate in the County Employees' Retirement System. This switch from a private pension program resulted in a proposed adjustment to increase pension expense by $122,555. This adjustment includes the non-capitalized portions of the employer's contribution at a rate of 7.95 percent plus the estimated annual cost for the purchase of past service credit of $75,000.

The Commission concurs with the calculation of the employer's contribution, or $89,628[13] of the total increase proposed, but finds that, the annual cost for the purchase of past service credit should be $71,563.[14] This results in a pro forma pension expense of $161,191, an increase of $131,684 over the test-year level. The Commission has included the non-capitalized portion of the increase, or $119,438,[15] as an adjustment to test-year expenses.

Administrative and General Expense

Campbell District sought to include in test-period operations miscellaneous expenses totaling $2,928 for its annual company picnic, employee tickets to a Cincinnati Reds baseball game, and flowers for employees and their relatives. The Commission finds that these expenses are not related to the provision of utility

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13 T.E., Exhibit F, Schedule 3(2.2).

14 Letter of Ronald J. Barrow to Lee M. MacCracken (providing information requested at August 1, 1991 Hearing, Item 3).

15 $131,684 x .907 = $119,438.

service and that Campbell District's ratepayers receive no benefit from such expenditures. In accordance with past Commission precedent,[16] the Commission has disallowed these expenses and decreased administrative and general expenses by $2,928.

Campbell District has also included as miscellaneous expenditures the cost of a gas main extension ($12,700) and a new boiler and associated piping ($6,987). The Commission finds that for rate-making purposes these expenditures should be capitalized. Accordingly, the Commission has made an adjustment to decrease test-year administrative and general expense by an additional $19,687.

Depreciation Expense

Campbell District proposed to increase test-year depreciation expense by $131,985.[17] The Commission concurs with the proposed inclusion of $12,645 to reflect the amortization of the loss on Campbell District's disposal of a three million gallon storage

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16 See, e.g., Case No. 89-348, Notice of Adjustment of the Rates of Kentucky-American Water Company, Order dated June 28, 1990, at 14; Case No. 90-013, Rate Adjustment of Western Kentucky Gas Company, Order dated September 13, 1990, at 30-31; Case No. 90-041, An Adjustment of Gas and Electric Rates of The Union Light, Heat and Power, Order dated October 2, 1990, at 28; Case No. 90-152, Green River Electric Corporation's Notice of Increase in Rates for Retail Electric Service, Order dated December 21, 1990, at 13.

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Annual amortization of retirement of water storage tank	$ 12,645
Crestview Acquisition	8,040
Depreciation for projects approved in Case No. 89-029 not included in test period	111,300
Total Proposed Increase	$131,985

tank in 1988. The Commission, however, finds that Campbell District's proposed adjustment of $8,040 to reflect depreciation on the plant acquired from the city of Crestview should be limited to $4,020. Campbell District officials testified that test-year depreciation expense already included a portion of this plant's depreciation.[18]

Campbell District sought an adjustment to depreciation expense of $111,300 for projects approved in Case No. 89-029. Only 6 of these projects have been constructed and placed into service in the test year or following the test year. Campbell District has proposed adjustments to reflect the revenues and expenses created by these 6 projects. In accordance with the policy announced in prior cases,[19] the Commission has increased

18 T.E. at 138-139.

19 See, e.g., Case No. 10481, Notice of Adjustment of the Rates of Kentucky-American Water Company, Order dated August 22, 1989, at 5. ("[A]djustments for post-test year additions to plant in service should not be requested unless all revenues, expenses, rate base, and capital items have been updated to the same period as plant additions...").

test-year depreciation expense by $60,725[20] to reflect the depreciation of these completed projects.

The Commission has determined that depreciation expense should not be allowed for Projects 89-1, 89-2, and 89-6 as these projects have either not been completed or not yet placed into service. No depreciation expense has been incurred for these projects nor will it be incurred until the projects are in service.

The Commission has made an additional adjustment to include the depreciation of the gas main and boiler discussed above using a service life of 35 years and 10 years, respectively. This adjustment results in a total increase of $1,062.

Based on the aforementioned adjustments, the Commission finds the net increase to depreciation expense to be $78,452.

<u>Rate Case Expense</u>

Campbell District proposed an increase to annual amortization of rate case expense of $13,333. It incurred rate case expense of

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	Cost	Service Life	Annual Depreciation
Project 89-3	$1,396,000	40 yrs.	$ 34,900
Project 89-4	158,000	40 yrs.	3,950
Project 89-5	135,000	40 yrs.	3,375
Project 89-7	279,000	40 yrs.	6,975
Project 89-8	91,000	40 yrs.	2,275
Project 89-9	185,000	20 yrs.	9,250
Total Annual Expense			$ 60,725

See Case No. 89-029, Prefiled Testimony of Barry Y. Dixon, at 5; Application of Campbell District, Exhibit S, Schedule 8(23).

$34,262.[21] The Commission finds that this expense should be amortized over a period of 3 years, and that rate case expense should accordingly be increased by $11,421.

Transmission and Distribution Expense

Campbell District proposed to increase transmission and distribution expense by $16,300 to allow for projected expenses associated with the construction projects approved in Case No. 89-029. Campbell District calculated the ratio of transmission and distribution expense to total transmission and distribution plant. This ratio was then applied to the amount of newly constructed plant to determine the amount of additional expense associated with maintaining the new transmission and distribution plant.

The record does not support this methodology. Campbell District can cite no authority which endorses this methodology. The underlying assumption of the methodology, that maintenance costs vary in direct proportion to the level of plant in service, has never been proven. No studies have been cited in support of this assumption. The methodology ignores the fact that some maintenance costs will be covered under contractor's warranty. As it is based upon the maintenance costs of older plant which may have greater maintenance requirements, this methodology is less suited for recently constructed plant.

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21 Letter from Ronald J. Barrow to Lee M. MacCracken (September 3, 1991)(providing actual rate case expenses).

The Commission notes that the adjustment is not based upon test-period figures. Rather than use the expense and plant levels associated with the test year, Campbell District used 1988 levels. Using test-year levels, the proposed adjustment would be only $12,100. Campbell District has been unable to explain the large decrease in the adjustment where a different year's figures are used.

Finally, the Commission rejects Campbell District's contention that this expense should be treated in the same manner as depreciation expense. The United States Supreme Court rejected this contention long ago. See, e.g., Lindheimer v. Illinois Bell Telephone Co., 292 U.S. 151 (1934).

Based on the foregoing, the Commission finds that the proposed adjustment is not known and measurable and denies it.

Customer Accounts Expense

Campbell District's adjustments to reflect revenues and expenses for 72 new customers included an increase to customer accounts expense of $18.01 per customer, or $1,297. The cost per customer was based on the test-year customer accounts expense divided by the test-year customer level. Customer accounts expense, which consists primarily of fixed costs, would remain the same regardless of the number of customers. Therefore, the Commission finds that this adjustment does not meet the criteria of being known and measurable and should not be included in test-year expenses.

Other Deductions

In its calculation of proposed revenue requirements, Campbell District failed to include the amortization of debt discount in the amount of $10,722 as an expense. The Commission finds that such expense should be included and, accordingly, has adjusted test year expenses for rate-making purposes to reflect this expense.

Summary

Based on the aforementioned adjustments, Campbell District's test-year operations appear as follows:

	Proposed Test Year	Commission Adjustments	Test Year Adjusted
Operating Revenue	$4,475,230	$ 280,005	$4,755,235
Operating Expenses	3,458,197	429,326	3,887,523
Operating Income	$1,017,033	$ (149,321)	$ 867,712
Other Income	203,363	(113,754)	89,609
Other Deductions	-0-	10,722	10,722
Income Available for Debt Service	$1,220,396	$ (273,797)	$ 946,599

DEBT SERVICE REQUIREMENT

In Case No. 89-029 the Commission authorized Campbell District to issue revenue bonds in the amount of $5.535 million. Campbell District has yet to issue these bonds, but plans to do so later this year. In the present case, Campbell District advised the Commission that this bond issuance will be in the principal amount of approximately $5,300,000.[22] A portion of the proceeds of this issuance will be applied toward retiring the outstanding bond anticipation notes. The Commission has reviewed the calculation of the proposed debt service requirement in light of this development and finds it to be reasonable. Campbell District's General Bond Resolution requires a debt service coverage of 1.25 times the maximum annual debt service. The maximum annual debt service for Campbell District's existing Series 1989 bonds and proposed Series 1991 bonds occurs in 1998 at a level of $1,091,327.50.[23]

REVENUE REQUIREMENT

The Commission finds Campbell District's annual revenue requirement to be $5,285,891.[24] To achieve a level of income sufficient to meet its reasonable expenses and debt service, the

22 T.E., Exhibit F, Schedule 1.

23 T.E., Exhibit F, Schedule 1, Campbell District's Response to the Commission's Order of March 4, 1991, Item 1.

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Maximum Annual Debt Service	$1,091,327
25% Debt Service Coverage	272,832
Silver Grove Debt Service	3,487
City of Crestview Debt Service	20,000
Total Annual Debt Service	$1,387,646
Add: Adjusted Operating Expense	3,887,523
Other Deductions	10,722
Total Revenue Requirement	$5,285,891

Commission further finds that Campbell District's rates should be adjusted to produce additional annual revenues of $441,047.[25]

RATE DESIGN

Campbell District's current rate design for its general metered customers consists of two increments ranging from a minimum usage category of 3,000 gallons to an all-over 3,000 gallons level. The first step is designed to cover fixed costs such as amortization, debt coverage and depreciation. The second step is designed to cover commodity costs such as operating and maintenance expenses as a cost per unit of volume. Campbell District charges its three wholesale customers by flat rate.

Campbell District did not propose to change the rate structure now in effect. The Commission finds that it is in the public interest to maintain Campbell District's current rate design. We further find that the rate increase granted herein should be spread over the existing rate structure so that the percentage of revenue from general customers and revenue from water sold for resale remains the same as established in prior cases. Campbell District has produced cost-of-service studies on its wholesale customers. Adjustments have been made to the flat rates charged to Campbell District's wholesale customers to ensure

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Total Revenue Requirement	$5,285,891
Less: Adjusted Operating Revenues	4,755,235
Other Income	89,609
Revenue Increase Required	$ 441,047

that the revenue produced by each customer matches the cost it imposes upon Campbell District.

SUMMARY

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

1. The rates in Appendix A, which is attached hereto and incorporated herein, are the fair, just and reasonable rates for Campbell District and will produce annual revenues of $5,285,891 based on adjusted test-year sales.

2. The rates proposed by Campbell District would produce revenue in excess of that found reasonable herein and should be denied.

IT IS THEREFORE ORDERED that:

1. Campbell District's proposed rates are denied.

2. The rates in Appendix A are approved for services rendered on and after the date of this Order.

Done at Frankfort, Kentucky, this 4th day of October, 1991.

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. 91-039 DATED 10/04/91

The following rates and charges are prescribed for the customers in the area served by Campbell County Kentucky Water 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.

RATE SCHEDULE

First 3,000 gallons used per quarter	$16.00	Minimum Bill
Over 3,000 gallons used per quarter	2.85	per 1,000 gallons

MINIMUM QUARTERLY RATES

Meter Size	Minimum Usage	Minimum Bill
5/8 Inch Meter	3,000 gallons	$ 16.00
3/4 Inch Meter	4,444 gallons	20.12
1 Inch Meter	11,757 gallons	40.96
1-1/2 Inch Meter	28,610 gallons	89.00
2 Inch Meter	47,560 gallons	143.01
3 Inch Meter	140,050 gallons	406.63
4 Inch Meter	260,440 gallons	749.78
6 Inch Meter	642,369 gallons	1,838.39

Wholesale Customers

Pendleton County Water District	$ 1.6048 per 1,000 gallons
City of Highland Heights	1.4132 per 1,000 gallons
Kenton County Water District No. 1	1.1986 per 1,000 gallons