

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLIATION OF MADISON COUNTY UTILITY)	
DISTRICT FOR (A) AUTHORITY TO FINANCE)	
CONSTRUCTION IN THE APPROXIMATE)	
AMOUNT OF \$3,000,000; (B) A CERTIFICATE)	CASE NO. 2002-00184
OF CONVENIENCE AND NECESSITY FOR THE)	
CONSTRUCTION OF WATER FACILITIES; AND)	
(C) ADJUSTMENT OF RATES)	

ORDER

Madison County Utility District (Madison) was created through the merger of Kingston-Terrill, Waco, and White Hall water districts. At the time of merger Madison adopted each of the former district s rate schedules and continues to charge those rates in each of the former district s territories. On July 11, 2002, Madision submitted an application to this Commission seeking approval of: (1) a Certificate of Public Convenience and Necessity to construct a \$3,047,500¹ waterworks improvement project, (2) the projects financing, and (3) adjustments to its filed tariff that would unify its rates for water service. The application was considered filed on August 9, 2002, when all filing deficiencies were cured. By Commission Order dated August 19, 2002, the Attorney General (AG), through his Office of Rate Intervention, was granted leave to intervene in the proceedings.

To avoid delaying construction of the proposed facilities the Commission entered an Interim Order dated August 14, 2002, approving the construction and financing portions of the application. The Interim Order suspended the proposed rates until such

¹ Madison s Application, Exhibit 2, Section 2, Cost Summary.

time as proper review by the Commission could be performed. To establish its process of review the Commission issued a procedural schedule along with its initial request for information by Order dated August 20, 2002.

Commission Staff exhausted the requests for information as established by the August 20, 2002 procedural schedule. The AG did not request information from Madison. Therefore, upon a motion of Madison for an extension of time to respond to Staff interrogatories, the Commission, by Order dated November 15, 2002, amended the original procedural schedule so that the case would stand submitted for decision if no requests for hearing were received on or prior to December 3, 2002.

Having received no such request, this case now stands submitted to the Commission. This Order addresses the Commission's findings and determinations on the issues presented and disclosed upon the investigation of Madison's revenue requirement.

ANALYSIS AND DETERMINATION

Test Period

As authorized by KRS 278.192(1), Madison utilized a historical test period consisting of 12 consecutive months. The initial application first stated the test year to be the 12 months ended April 30, 2002.² Madison later clarified the test period as the 12 months ended March 31, 2002.³ Pursuant to 807 KAR 5:001, Section 10(7),

² Madison's Application, Exhibit 2, Section 1, April 2002 Test Period Financial Data.

³ Madison's Response to Commission Staff's Supplemental Interrogatories and Requests for Production of Documents dated October 14, 2002 (Staff's October 14, 2002 Request), Item 2.

Madison is allowed to adjust test-year financial results for known and measurable changes.

In its August 9, 2002 response to the Commission's deficiency notice dated July 29, 2002, Madison provided an adjusted operating statement that details test-year revenues and expenses and all proposed adjustments. A summary of Madison's adjusted operating statement is shown in Appendix A of this Order.

After reviewing the record, the Commission has determined the appropriate adjustments to test-year operations. These adjustments are described in the following section of this Order. Madison's adjusted operating statement as determined by this Commission is shown at Appendix B.

Operating Revenues and Expenses

Operating Revenues from Rates. Test-year revenue from rates was reported in the 2001 Annual Report as \$2,471,071. Madison provided usage information for the test year in a Microsoft® Excel 97 spreadsheet format in response to Staff's September 16, 2002 Request.⁴ The usage information filed produced revenue from rates equal to \$2,476,511 for water sales.

Expenses Adjusted Based on Historical Trends. Madison proposed that the following adjustments were necessary and appropriate in determining pro forma operations:

⁴ Madison's Response to Commission Staff's Interrogatories and Requests for Production of Documents dated September 16, 2002 (Staff's September 16, 2002 Request), Item 28.

Late Charges and Other Revenues	\$1,332
Interest Income	632
Purchased Water	78,420
Bad Debt Expense	806
Insurance Bonding	5,367
Miscellaneous	2,186
Office Expense / Supplies	1,973
Rent	854
Truck Expense	1,579
Utilities and Telephone	1,307

These adjustments reflect projections of increased revenues and expenses based on historical trends. Madison did not provide definitive evidence to support these projections. These adjustments do not meet the known and measurable criteria for adjusting test-year financial information as established by 807 KAR 5:001, Section 10(7). They are therefore denied.

2001 Audit Adjustments. Test-year expenses reported by Madison did not reflect the 2001 audit adjustments. We have included those adjustments in pro forma operations as follows:

Depreciation Expense	\$2,095
Insurance and Bonding	1,072
Miscellaneous	41
Payroll Taxes and Employee Benefits	(1,364)
Professional Services	(15,491)
Repairs and Maintenance	17,138
Truck Expense	(1,333)

Purchased Water. Test-year purchased water expense was reported at \$1,307,004. The Commission finds good cause to adjust this amount when determining pro forma operations. Early in 2002 the city of Richmond increased the wholesale water rate charged to Madison.⁵ The current rate is \$1.65 per 100 cubic feet or \$2.20 per

⁵ Madison s Response to the Commission s Order dated August 20, 2002, Item 3(a).

1,000 gallons.⁶ Additionally, an adjustment is warranted to match purchased water expense with normalized water sales of 74,665,828 cubic feet as determined in the aforementioned Operating Revenues from Rates adjustment.

The adjustment is calculated as follows:

Normalized Test Year Sales	74,665,828.00
Divide by: Percentage of Water Sold to Purchased	<u>85.09%</u> ⁷
1,000 Gallons to be Purchased	87,749,240.00
Times: Rate per 100 cubic feet (\$1.65 City of Richmond+ .04 KRA KRA Assessment)	<u>\$1.69</u>
Pro forma Purchased Water	1,482,962.00
Less: Test year	<u>(1,307,004.00)</u>
Adjustment	<u>\$175,958.00</u>

Commissioners Salaries. Madison reported test-year commissioner salary expense in the amount of \$22,800. Each commissioner receives \$300 per month. Madison began the test year with seven commissioners but finished the year with six.⁸ Madison proposed to increase the test-year amount to \$24,000 based on an average number of commissioners of 6.67 for the year 2002.

We find that Madison's adjustment is not warranted. They had only six commissioners on the Board at the end of the test year and plan to reduce that number

⁶ Madison's Response to Staff's September 16, 2002 Request, Item 20.

⁷ Madison's Response to Staff's October 14, 2002 Request, Item 12. Note that the percentage as stated here does not represent water loss but rather the percentage of water sold to purchased.

⁸ Id., Item 7.

to 5 as terms expire.⁹ We further find that the test year amount should be reduced by \$1,200 (\$300 monthly fee x 6 Commissioners x 12 months = \$21,600 22,800 test year amount) to reflect six commissioners serving an entire year.

Depreciation and Amortization. All known and measurable costs related to the plant additions approved by the Commission's Interim Order dated August 14, 2002 shall be reflected in the rates approved by this Order. Depreciable costs of the proposed project total \$2,976,500.¹⁰ To calculate the depreciable basis of the proposed mains and storage facility, administrative and design costs were allocated based on the proportionate direct costs of each improvement. The adjustment to test-year expenses was calculated as follows:

	Direct Cost	Percentage	Allocation of Administrative and Design	Total	Divide by Depreciable Life	Depreciation Expense
Cost of Tank	585,100	24%	115,631	700,731	40	17,518
Cost of Mains	1,900,233	76%	375,536	2,275,769	50	45,515
Total	<u>2,485,333</u>	100%	491,167	2,976,500		<u>63,034</u>

Test-year expenses include depreciation taken on service mains that are to be replaced during the proposed construction. These amounts must be eliminated when calculating rates otherwise pro forma depreciation expense will be overstated. Madison estimated

⁹ Id.

¹⁰ Total Cost \$3,047,500
Less: Cost of Issuance (27,500)
Cost of Land (43,500)
Depreciable Costs \$2,976,500

depreciation expense on the retired assets to be \$15,784.¹¹ The Commission accepts this amount and has reduced test-year expenses accordingly.

It has also come to the Commission's attention that during the test year, 1,091 meters were replaced without their costs being removed from the plant ledger. This oversight requires no adjustment in this proceeding as the meters had been fully depreciated.¹² Madison is reminded to take particular care in recording plant additions and retirements so that its plant ledger accurately reflects plant in service.

Amortization of debt issuance costs for the proposed long-term debt should also be reflected in rates. Debt issuance costs are estimated to be \$27,500.¹³ Test-year expenses have been increased by \$1,375 (27,500/20 years) to reflect straight-line amortization over the 20-year life of the debt.

Professional service expenses related to this case that are not to be paid out of debt proceeds total \$1,500.¹⁴ This amount has been amortized over 3 years by increasing test-year expenses by \$500.

Payroll Taxes, Employee Benefits, and Salaries and Wages. Madison reported test-year payroll taxes and employee benefits at \$79,673 and salaries and wages at \$381,770.

¹¹ Madison's Response to the Commission's Order dated August 20, 2002, Item 1.

¹² Madison's Response to Staff's September 16, 2002 Request, Item 22(a).

¹³ Madison's Application, Exhibit 2, Section 2, Cost Summary.

¹⁴ Madison's Response to Staff's October 14, 2002 Request, Item 3.

Madison proposed to increase test-year salaries and wages by \$52,110 to reflect the hiring of two new field employees. Its adjustment is based on an hourly pay rate of \$10 for regular hours and \$15 per hour for 400 annual overtime hours per employee.

The Commission does not dispute whether or not Madison's work force is currently adequate. However, any adjustment to Madison's test-year expenses must be known and measurable. Madison currently has not hired the new employees nor has it indicated their hiring other than to state that it will occur subsequent to the effective date of the rates proposed in this case.¹⁵ The Commission has found no evidence in the record definitive enough to find this adjustment known and measurable. It is therefore denied.

Madison proposed to increase payroll taxes and employee benefits by \$11,951 to reflect the two new employees plus a general 3 percent increase. That portion of the adjustment related to the two new employees is denied on the same merit as the salary adjustment. The 3 percent increase has not been substantiated by Madison as known and measurable, and it is therefore denied as well.

Professional Services. Madison proposed to increase test-year engineering services by \$13,505 for designing the repair work for the Continental Lane Tank.¹⁶ This adjustment is being denied as it is not known and measurable. Furthermore, it would not be appropriate to include the entire amount in annual expenses. For a complete explanation of this finding, refer to the discussion of the proposed Continental Lane Tank repair work as it appears in the Repairs and Maintenance section of this Order.

¹⁵ Madison's Response to the Commission's Order dated August 20, 2002, Item 3(l)(1).

¹⁶ Id., Item 3(f).

It is clear from reviewing the record in this case that Madison has routinely employed the services of legal counsel outside of the elected county attorney's office without proper authorization from the county judge/executive.¹⁷ At this time the Commission will not require adjustment of test-year professional services but will remind Madison that it is in direct violation of KRS 74.030 by failing to get the required approval.

Repairs and Maintenance. Madison reported test-year repairs and maintenance expense at \$126,819 and proposed to increase that amount by \$413,641. Madison detailed the adjustment as follows:¹⁸

Historical trend, 5 percent increase	\$ 6,341
600 meter change outs	52,800
Repairs to Continental Lane Tank	324,500
Annual evaluation of storage facilities	<u>30,000</u>
Total	<u>\$413,641</u>

The historical trend adjustment is denied as it is not known and measurable. For a complete explanation as to why this adjustment is not appropriate refer to the Historical Trend adjustments as previously discussed and denied in this Order.

During the test year Madison replaced 1,091 meters that were appropriately capitalized and depreciated over their estimated useful lives.¹⁹ Yet, Madison wishes to include in pro forma operations as an annual expense the full cost of replacing 600 meters. This adjustment is unwarranted and it is denied. Water districts are given the

¹⁷ Madison's Response to Staff's October 14, 2002 Request, Item 5.

¹⁸ Madison's August 9, 2002 response to deficiency notice.

¹⁹ Madison's Response to Staff's September 16, 2002 Request, Item 22(a).

opportunity to recover depreciation expense as a recovery of replacement costs for all assets. In this Order Madison has been granted \$304,315 in depreciation and amortization expense. It appears that this amount will be adequate for all annual replacements anticipated by Madison.

Madison proposed to include in annual pro forma expenses the full amount of estimated tank painting and repair costs to the Continental Lane Tank. The amount requested is based on an engineering estimate. Madison has not yet received bids for the work.²⁰ Short of negotiated contractor bids that secure the cost and timing of such major repairs the Commission cannot find this adjustment to be known and measurable. It is therefore denied.

It should be noted that had recovery of these costs been granted the entire amount of the expenditure would not have been allowed in annual expenses. Instead, the full amount would have been amortized and/or depreciated over its estimated useful life so that only a portion of the costs would be recognized in annual expenses. This treatment parallels the theory of capitalizing and depreciating assets. Madison should follow this accounting procedure to record the cost of tank repairs when they are incurred to ensure that they are properly included in test-year expenses and reflect in Madison's next rate proceeding.

The Commission is not oblivious to the fact that Madison believes its cash reserves are not sufficient to finance the necessary tank repairs.²¹ If Madison finds the

²⁰ Madison's Response to the Commission's Order dated August 20, 2002, Item 3(h)(8).

²¹ Madison's Response to Staff's September 16, 2002 Request, Item 23(a).

rates approved in this Order to be inadequate, it is reminded that through KRS 74.395 a surcharge can be established and charged for such projects for up to 5 years prior to the project's starting date. State law requires far less cost documentation to establish a surcharge than to recover such costs through general rates. Of course, costs recovered through such a surcharge provision would be excluded from future recovery through general rates for service.

Madison also proposed to increase test-year expenses by \$30,000 to cover the maintenance, repair and inspection of three other tanks. The amount proposed is based on unsubstantiated estimates. Madison has not provided any evidence that proves the amount known and measurable. The adjustment is therefore denied. If an adjustment of this nature were to be approved, the amount would be offset by test-year amounts paid for tank inspection, maintenance and cleaning fees unless it was proven that the proposed fees were in addition to the test-year amounts. As it stands, we have allowed all the test-year fees related to tank maintenance and inspections to remain in annual pro forma expenses whether through depreciation/amortization expense or contracted services.

Revenue Requirement and Rate Determination

Appendix C of this Order compares the revenue requirement from rates as requested by Madison and the Commission of \$3,295,411 and \$2,938,976, respectively. Through reviewing the billing information submitted by Madison it was determined that the rates proposed by Madison will generate only \$2,807,317 and not \$3,180,963²² as purported by Madison. The proposed rates do however produce revenues sufficient to

²² Madison's Response to Staff's October 14, 2002 Request, Item 14(a).

pay the immediate annual debt payments and pro forma cash expenses as delineated in Appendix B. The proposed rates and rate structure developed by Madison and the methodology that Madison incorporated in the development of these do not follow the methodology of the American Water Works Association Manual M-1. However, since Madison's proposed rates are sufficient to meet its cash needs, the Commission finds that they should be approved in this case. Should Madison decide to further increase rates to generate the \$2,938,976 revenue requirement as determined by the Commission, it shall provide written confirmation to the Commission and publish notice of those rates pursuant to 807 KAR 5:011, Section 8.


IT IS THEREFORE ORDERED that:

1. The rates proposed by Madison in its application and included in Appendix D of this Order are approved for service rendered by Madison on and after the date of this Order.
2. Madison shall provide to the Commission written notice within 10 days from the date of this Order if it wishes to adjust the rates in Appendix E to produce annual revenues from rates of \$2,938,976. Otherwise, Madison shall file with the Commission its revised tariff setting out the rates approved herein within 30 days from the date of this Order.
3. Three years from the date of this Order, Madison shall file an income statement, along with any pro forma adjustments, in sufficient detail to demonstrate that the rates approved herein are sufficient to meet its operating expenses and annual debt service requirements.

Done at Frankfort, Kentucky, this 27th day of January, 2003.

By the Commission

ATTEST:

A handwritten signature in black ink, appearing to read "Charles H. [unclear]", written over a horizontal line.

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2002-00184 dated January 27, 2003

ADJUSTED OPERATING STATEMENT AS REQUESTED BY MADISON

Operating Revenue			
Water Sales	2,471,071	(20,735)	2,450,336
Other Operating Revenue	133,174	1,332	134,506
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Total Operating Revenue	2,604,245	(19,403)	2,584,842
Operating Expenses			
Purchased Water	1,307,004	78,420	1,385,424
Bad Debt Expense	16,115	806	16,921
Commissioner's Salaries	22,800	1,200	24,000
Depreciation	253,095	-	253,095
Insurance and Bonding	35,783	5,367	41,150
Miscellaneous	14,574	2,186	16,760
Office Expense and Supplies	39,451	1,973	41,424
Payroll Taxes and Employee Benefits	79,673	11,951	91,624
Professional Services	27,010	13,505	40,515
Rent	17,078	854	17,932
Repairs and Maintenance	126,819	413,181	540,000
Salaries and Wages	381,770	52,110	433,880
Truck Expense	31,572	1,579	33,151
Utilities and Telephone	26,135	1,307	27,442
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Total Operating Expenses	2,378,879	584,439	2,963,318
Net Operating Income	225,366	(603,842)	(378,476)
Interest Income	63,160	632	63,792
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Income Available to Service Debt	288,526	(603,210)	(314,684)

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2002-00184 dated January 27, 2003

ADJUSTED OPERATING STATEMENT AS DETERMINED BY THE COMMISSION

Operating Revenue			
Water Sales	2,471,071	5,440	2,476,511
Other Operating Revenue	133,174		133,174
			<hr/>
Total Operating Revenue	2,604,245	5,440	2,609,685
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Operating Expenses			
Purchased Water	1,307,004	175,958	1,482,962
Bad Debt Expense	16,115		16,115
Commissioner's Salaries	22,800	(1,200)	21,600
Depreciation and Amortization	253,095	2,095	
		63,034	
		(15,784)	
		1,375	
		500	304,315
Insurance and Bonding	35,783	1,072	36,855
Miscellaneous	14,574	41	14,615
Office Expense and Supplies	39,451		39,451
Payroll Taxes and Employee Benefits	79,673	(1,364)	78,309
Professional Services	27,010	(15,491)	11,519
Rent	17,078		17,078
Repairs and Maintenance	126,819	17,138	143,957
Salaries and Wages	381,770		381,770
Truck Expense	31,572	(1,333)	30,239
Utilities and Telephone	26,135		26,135
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Total Operating Expenses	2,378,879	226,041	2,604,920
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Net Operating Income	225,366	(220,601)	4,765
Interest Income	63,160		63,160
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Income Available to Service Debt	288,526	(220,601)	67,925
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APPENDIX C

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2002-00184 dated January 27, 2003

COMPARISON OF REVENUE REQUIRED RATE CALCULATIONS

	Requested by Madison	As Determined by the Commission
Operating Expenses	2,963,318	2,604,920
Existing Bond Payment, Principal and Interest	272,825	272,825
New KIA Loan Payment, Principal and Interest	169,167	169,167
Coverage at 20 Percent of Principal and Interest	<u>88,398</u>	<u>88,398</u>
Total Revenue Required	3,493,708	3,135,310
Less: Other Operating Revenues	(134,506)	(133,174)
Interest Income	<u>(63,792)</u>	<u>(63,160)</u>
Revenue Required from Rates	<u><u>3,295,411</u></u>	<u><u>2,938,976</u></u>

APPENDIX D

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2002-00184 dated January 27, 2003

The following rates and charges are prescribed for the customers in the area served by Madison County Utility 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 Water Rates

First	280	cubic feet	\$ 10.00	Minimum bill
Next	720	cubic feet	4.00	per 100 cubic feet
Next	3,000	cubic feet	3.50	per 100 cubic feet
Next	8,000	cubic feet	3.00	per 100 cubic feet
Next	88,000	cubic feet	2.75	per 100 cubic feet
Over	100,000	cubic feet	2.50	per 100 cubic feet

APPENDIX E

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2002-00184 dated January 27, 2003

Monthly Water Rates Calculated during Commission Review

First	280	cubic feet	\$ 11.93	Minimum bill
Next	720	cubic feet	3.67	per 100 cubic feet
Next	3,000	cubic feet	3.47	per 100 cubic feet
Next	8,000	cubic feet	3.30	per 100 cubic feet
Next	88,000	cubic feet	3.13	per 100 cubic feet
Over	100,000	cubic feet	2.86	per 100 cubic feet