

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF NORTHERN KENTUCKY	)	
WATER DISTRICT FOR (A) FOR AN	)	
ADJUSTMENT OF RATES; (B) A CERTIFICATE	)	CASE NO.
OF PUBLIC CONVENIENCE AND NECESSITY	)	2003-00224
FOR IMPROVEMENTS TO WATER FACILITIES	)	
IF NECESSARY; AND (C) ISSUANCE OF BONDS	)	

ORDER

Northern Kentucky Water District (“Northern District”) has applied for a Certificate of Public Convenience and Necessity (“Certificate”) to construct improvements to its water facilities, for authority to issue \$10,455,000 in revenue bonds, and for authority to increase its water rates. In its application, Northern District proposes to adjust its rates to increase the normalized revenues from water sales by \$2,518,862 to \$33,004,137.<sup>1</sup> Northern District subsequently revised its proposed rate adjustment to increase normalized revenues from water sales by \$2,215,997.<sup>2</sup> By this Order, we authorize the requested financing, grant the requested Certificate for the Sub-district K project, and establish rates that will produce an annual increase in revenues from water sales of \$1,499,982.

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<sup>1</sup> Application, Exhibit N, Cost-of-Service Study at 3.

<sup>2</sup> Response 7 to Staff’s Hearing Data Requests filed February 18, 2004, Schedule of updated test year adjustments.

## BACKGROUND

Northern District, a water district organized pursuant to KRS Chapter 74, is a utility subject to Commission jurisdiction. KRS 278.010(3)(d); KRS 278.015; KRS 278.040. It provides retail water service to 70,725 customers in Kenton and Campbell counties, Kentucky and wholesale water service to the Bullock Pen Water District, the Pendleton County Water District, and the city of Walton, Kentucky.<sup>3</sup> Northern District was formed on January 1, 1997 from the merger of Kenton County Water District No. 1 and Campbell County Kentucky Water District.<sup>4</sup> It last applied for a rate adjustment in 2002.<sup>5</sup>

## PROCEDURE

Northern District submitted written notice of its intent to file an application for an adjustment of rates on June 12, 2003. On August 28, 2003, Northern District tendered its application. Because this application failed to comply with 807 KAR 5:001, Section 10, the Commission did not accept it for filing until September 22, 2003, after Northern District cured the application's deficiencies. On October 1, 2003, the Commission

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<sup>3</sup> Northern District's Application, Exhibit C, Annual Report of Northern District to the Public Service Commission of the Commonwealth of Kentucky for the Calendar Year Ended: December 31, 2002 ("2001 Annual Report") at 29 and 31.

<sup>4</sup> See Case No. 1996-00234, The Joint Application of Kenton County Water District No. 1 and Campbell County Kentucky Water District for Authority to Merge Into Northern Kentucky Water Service District, and for Authority for the Combined District to Operate (August 22, 1996).

<sup>5</sup> See Case No. 2002-00105, Application of Northern Kentucky Water District for (A) an Adjustment of Rates; (B) a Certificate of Public Convenience and Necessity for Improvements to Water Facilities if Necessary; and (C) Issuance of Bonds (April 30, 2003).

suspended the rates until March 21, 2004 and established this proceeding to investigate the reasonableness of Northern District's proposed rates.

The Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention ("Attorney General"), is the only intervenor in this proceeding. Following extensive discovery, the Commission held a public hearing on the proposed rate adjustment on February 10, 2004. The following persons testified on behalf of Northern District: Terrell Ross, Chairman and Secretary of Ross, Sinclair and Associates, Inc.; Richard Harrison, Vice President of Engineering/Distribution of Northern District; Ronald Barrow, Vice President of Finance of Northern District; Peggy L. Howe, Principal Project Consultant for Black & Veatch; and Ron Lovan, President and Chief Executive Officer of Northern District. No other persons testified.

#### PROPOSED CONSTRUCTION

Northern District identifies approximately \$9.4 million of projects planned for construction in 2003 and states its proposed construction is part of an ongoing 5-year plan of improvements, which will necessitate a series of rate adjustments over the next several years.<sup>6</sup> Of the projects identified in Exhibit O of its application only the Supervisory Control and Data Acquisition Upgrade ("SCADA") and the Sub-district K projects require a Certificate. By its Orders of November 20, 2003 and May 11, 2004, the Commission granted Certificates for the first and second phases of the SCADA project.

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<sup>6</sup> Northern District's Application at 3.

Northern District's Sub-district K project involves the construction of approximately 2.8 miles of a 12-inch water main on Klette and Rice Roads<sup>7</sup> to serve potentially 48 new customers.<sup>8</sup> Northern District estimates the total construction cost will be \$626,000. It proposes to fund this cost with a Kentucky Infrastructure Authority grant of \$229,680, surcharge revenues from the customers served in the Sub-district K area of \$375,634, and Northern District's contribution of \$250,366 for the upgrade costs.<sup>9</sup>

### ISSUANCE OF REVENUE BONDS

Northern District proposes to fund the total cost of its construction projects from the issuance of \$10,455,000 in parity revenue bonds that it estimates will have a 25-year term with interest rates that vary from 1.11 to 5.00 percent per annum.<sup>10</sup> These funds will allow Northern District to repair and replace deteriorated or inadequate infrastructure and to make improvements to the treatment and distribution system.<sup>11</sup>

### TEST PERIOD

Northern District proposes to use the 12-month period ending May 31, 2003 as the test period to determine the reasonableness of its proposed rates. We find the use of this period reasonable. In using a historic test period, the Commission gives full consideration to appropriate and known and measurable changes.

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<sup>7</sup> Id., Exhibit O, 2003 Rate Case Projects at 73.

<sup>8</sup> Northern District's January 23, 2004 response to Staff's questions at the January 15, 2004 informal conference.

<sup>9</sup> Id.

<sup>10</sup> Northern District's Application, Exhibit A, Plan of Financing.

<sup>11</sup> Id. at 2-3.

## INCOME STATEMENT

For the test period, Northern District reports actual operating revenues and expenses of \$28,149,481 and \$22,825,904, respectively.<sup>12</sup> Northern District proposes several adjustments to revenues and expenses to reflect current and anticipated operating conditions, resulting in pro forma operating revenues of \$31,764,828<sup>13</sup> and pro forma operating expenses of \$23,249,226.<sup>14</sup> Subsequent corrections and revisions to the Cost-of-Service Study resulted in a revised level of pro forma operating revenues of \$32,069,831.<sup>15</sup> The Commission's review of these proposed adjustments is set forth below.

### Operating Revenues from Water Sales

Northern District reports test-period operating revenues from water sales of \$27,069,411.<sup>16</sup> The reported revenues from water sales are comprised of revenue from

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<sup>12</sup> Response to Item 1 of Commission Staff's Second Set of Interrogatories and Requests for Production of Documents to Northern District.

<sup>13</sup> Northern District's Application, Exhibit N	
Schedule 5, Revenues Not Subject to Rate Increase	\$ 1,279,553
Schedule 7, Test Year Revenue under Existing Rates	+ 30,485,275
Pro Forma Operating Revenue	<u>\$ 31,764,828</u>

<sup>14</sup> Northern District's Application, Exhibit N	
Schedule 1, Operation and Maintenance	\$ 18,596,697
Schedule 1, Depreciation	+ 4,652,529
Pro Forma Operating Expenses	<u>\$ 23,249,226</u>

<sup>15</sup> Response 7 to Commission Staff's Hearing Data Requests, Schedule of updated test year adjustments.

Schedule 5R, Revenues Not Subject to Rate Increase	\$ 1,575,675
Schedule 7R, Test Year Revenue under Existing Rates	+ 30,494,156
Pro Forma Operating Revenue	<u>\$ 32,069,831</u>

<sup>16</sup> Northern District's Application, Exhibit N, Schedule 7, Test Year Revenue Under Existing Rates.

retail water sales of \$21,993,072, revenue from bulk sales of \$5,381, and revenue from wholesale water sales of \$5,070,958.<sup>17</sup>

Northern District proposes to reduce its test-period revenues from wholesale water sales by \$3,958,575 to reflect the loss of the city of Florence (“Florence”) and Boone County Water District (“Boone District”) as wholesale customers.<sup>18</sup> Northern District’s current rates became effective for services rendered on and after June 10, 2003. To normalize its operating revenues to reflect a full 12 months of the increased rates, Northern District proposes to increase retail water revenues by \$6,705,706 and wholesale revenues by \$529,948.<sup>19</sup> It further proposes to increase retail water revenues by \$138,787 to reflect the addition of 48 new customers from the proposed Sub-District K project.<sup>20</sup> These adjustments result in a pro forma level of operating revenues from water sales of \$30,485,277, for an overall increase of \$3,415,866.

On July 23, 2003, Northern District acquired the operations of the city of Bromley (“Bromley”).<sup>21</sup> Northern District’s original Cost-of-Service Study reflects Bromley being a wholesale customer for 3 months and reflects the customers formerly served by Bromley as retail customers for 9 months. In its revised Cost-of-Service Study,

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<sup>17</sup> Id.

<sup>18</sup> See Case No. 2000-00206, An Investigation of Boone County Water District’s Decision to Change Water Suppliers and of the Amendment of Water Supply Agreements between Northern Kentucky Water Service District and Boone County Water District and the City of Florence, Kentucky (November 9, 2000).

<sup>19</sup> Northern District’s Application, Exhibit N, Schedule 7, Test Year Revenue Under Existing Rates.

<sup>20</sup> Id.

<sup>21</sup> Response to Item 43(a) of the Attorney General’s October 27, 2003 Information Request.

Northern District proposes to reduce wholesale revenues by \$9,273 and to increase its metered retail water sale revenues by \$18,153 to reflect a full 12 months of retail usage of the customers formerly served by Bromley.<sup>22</sup>

In reviewing Northern District's proposed adjustments to operating revenues from water sales, the Commission finds the adjustments reasonable and accepts them for rate-making purposes.

### Surcharge Revenues

In its application Northern District proposed to increase its test-period operating revenues by \$199,482 to reflect the sub-district surcharge revenues.<sup>23</sup> In its revised Cost-of-Service Study, Northern District increased its original adjustment by \$296,122 to a pro forma level of \$495,604.<sup>24</sup> The Commission finds that Northern District's proposed adjustment should be denied and operating revenues should be increased by \$556,008.

Prior to this application, Northern District received Commission approval to establish 8 separate sub-districts. A Northern District customer that resides in a sub-district service area is assessed a surcharge to cover the debt service for the installation of the 8-inch main constructed to provide service. If Northern District chooses to increase the main size from 8 inches for hydraulic or fire flow purposes to benefit the

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<sup>22</sup> Response 7 to Commission Staff's Hearing Data Requests filed February 18, 2004, Schedule of updated test year adjustments.

<sup>23</sup> Northern District's Application, Exhibit N, Schedule 5, Revenues Not Subject to Rate Increase.

<sup>24</sup> Response 7 to Commission Staff's Hearing Data Requests filed February 18, 2004, Schedule of updated test year adjustments.

entire system, then the upsizing cost is recovered from the entire customer base through Northern District's base rates.

Northern District provided a schedule of its sub-districts listing the surcharges that are effective for 2004 and the current number of customers within the boundaries of each sub-district.<sup>25</sup> Using this schedule and including the annual debt service to be recovered from the Sub-district K customers the Commission calculates an annual level of surcharge revenue of \$556,008 as follows:

<u>Description</u>	<u>Customer Level</u>	<u>2004 Surcharge</u>	<u>Annual Collections</u> <sup>26</sup>
Sub-district A	419	\$ 12.02	\$60,432
Sub-district B	255	\$ 21.38	65,424
Sub-district C	812	\$ 22.33	217,584
Sub-district D	70	\$ 30.00	25,200
Sub-district E	164	\$ 30.00	59,040
Sub-district R	233	\$ 19.39	54,216
Sub-district RF	28	\$ 30.00	10,080
Sub-district RL	86	\$ 37.50	38,700
Sub-district K		\$ 30.00	<u>+ 25,332</u>
Total			<u>\$556,008</u>

Salaries and Wages – Employees, Salaries and Wages - Officers, Taxes Other Than Income

Northern District A proposes to increase test-period operating expenses by \$288,254 to reflect employee wage increases made effective January 1, 2003. The average wage increase was 4.1 percent per employee.<sup>27</sup> To calculate its adjustment,

<sup>25</sup> Id., Response 2, Updated Sub-district schedule with current surcharge rates.

<sup>26</sup> Annual collections are based on rounded monthly amounts. Annual debt service for Sub-District K is \$25,332.

<sup>27</sup> Northern District's Application, Exhibit N, Schedule 2, Test-Year Operation and Maintenance Expense.

Northern District multiplied the monthly average salary and wage,<sup>28</sup> and payroll taxes<sup>29</sup> for the first 5 months in 2003 by 12 months to arrive at its pro forma level of \$7,244,728.<sup>30</sup>

At the hearing Mr. Barrow testified that Northern District's Board of Commissioners ("Board") granted its employees a 4 percent wage increase, which was effective January 1, 2004.<sup>31</sup> Using the actual salaries and wages and payroll taxes recorded in 2003, Northern District estimates a pro forma salaries and wage expense of \$7,662,352, an increase of \$417,624 above its original estimate.<sup>32</sup>

Northern District's methodology to calculate its pro forma salary and wage expense adjustment fails to take into account the fluctuation in the employee level that occurred at the end of the test period. The Commission believes that a more accurate approach would be to use the end-of-period employee level, the actual test-period overtime hours worked, and the 2004 wage rates. In response to an information request made at the hearing, Northern District provided an employee schedule containing the detailed information necessary for such an adjustment.<sup>33</sup> However,

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<sup>28</sup> Response to Item 5(a) of Appendix B of the Commission's October 1, 2003 Order.

<sup>29</sup> Id., Response to Item 5(c).

<sup>30</sup>  $\$2,812,356$  (Jan – May 2003 Sal. & Wages)  $\div$  5 Mo.  $\times$  12 Mo. =  $\$ 6,749,654$   
 $\$206,281$  (Jan – May 2003 FICA Taxes)  $\div$  5 Mo.  $\times$  12 Mo. =  $+ 495,074$   
Pro Forma Salaries & Wages  $\underline{\underline{\$ 7,244,728}}$

<sup>31</sup> Transcript of Evidence ("T.E.") for Hearing of February 10, 2004 at 47.

<sup>32</sup> Northern District's Hearing Exhibit 2, Estimated Adjustments to Expenses for the Year 2004.

<sup>33</sup> Response to Staff's Hearing Data Requests filed February 24, 2004.

Northern District included on its employee schedule the positions that were added as of January 1, 2004. These positions have been authorized by the Board but have not been filled.<sup>34</sup>

Using Northern District's employee schedule, the Commission calculates a pro forma level of salaries and wages, and payroll tax expense of \$7,525,225 as follows:

<u>Description</u>	<u>Salaries &amp; Wages</u>	<u>Payroll Taxes (FICA)</u>	<u>Totals</u>
Employee Schedule Totals	\$ 7,268,777	\$ 548,773	\$ 7,817,550
Less: Authorized but unfilled Positions	78,500	6,005	84,505
Less: Capitalized (2.7%)	- 193,165	- 14,655	- 207,820
Totals	<u>\$ 6,997,112</u>	<u>\$ 528,113</u>	<u>\$ 7,525,225</u>

In calculating this adjustment, the Commission excluded the positions that were authorized by the Board, but have not been filled. Because of the uncertainty of the hiring date, any adjustment to reflect those positions would not meet the rate-making criteria of being "known and measurable." Accordingly, Northern District's adjustment should be denied and its wages and salaries expense should be increased by \$510,808.

#### Employee Pensions and Benefits

Northern District reports test-period employee pensions and benefits expense of \$1,585,314, which includes employee health insurance expense of \$1,003,785. Northern District proposes to increase that amount by \$121,030 to reflect a 7.6 percent increase in health insurance costs.<sup>35</sup> To calculate its adjustment, Northern District

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<sup>34</sup> T.E at 53.

<sup>35</sup> Northern District's Application, Exhibit N, Schedule 2, Test-Year Operation and Maintenance Expense.

multiplied the monthly average employee health insurance expense for the first 5 months in 2003 by 12 months to arrive at its pro forma level of \$1,124,815.<sup>36</sup>

At the hearing Mr. Barrow testified that the health insurance premiums increased in 2004.<sup>37</sup> Northern District estimates that the 2004 premiums and the increase in the employer retirement contribution will result in an increase of \$190,118 to its pro forma employee pensions and benefits expense of \$1,706,344 for a revised pro forma expense level of \$1,896,462.<sup>38</sup>

In reviewing the employee schedule, the Commission notes that Northern District provides its Commissioners with the same benefits (i.e., health insurance, life insurance, and dental insurance) that it provides to all full-time employees. Since District Commissioners generally meet only once a month and do not work a 40 hour work week, these positions should be considered part-time employment.

In Case No. 2001-00211,<sup>39</sup> Hardin District provided family health insurance coverage for the members of its Board of Commissioners and its General Manager, but single coverage only for its remaining employees. In finding that the cost of family health insurance coverage should be eliminated, the Commission stated that, “[d]istinctions between board officials and other district employees is contrary to law.” In this instance

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<sup>36</sup> Response to Item 6(a) of Appendix B of the Commission’s October 1, 2003 Order.

<sup>37</sup> T.E. at 44-45.

<sup>38</sup> Northern District’s Hearing Exhibit 2, Estimated Adjustments to Expenses for the Year 2004.

<sup>39</sup> See Case No. 2001-00211, Application of Hardin County Water District No. 1 for (1) Issuance of Certificate of Public Convenience and Necessity; (2) Authorization to Borrow Funds and to Issue its Evidence of Indebtedness Therefor; (3) Authority to Adjust Rates; and (4) Approval to Revise and Adjust Tariff (March 1, 2002).

Northern District does not provide its other part-time employees with benefits comparable to those that are currently provided to its Commissioners.

Using the insurance premiums from the employee schedule, eliminating the benefits provided to the Commissioners, and including the employer retirement contribution at a rate of 7.34 percent, the Commission calculates a pro forma level of employee pensions and benefits expense of \$1,685,436, as follows:

<u>Description</u>	<u>Health</u>	<u>Life &amp; Dental</u>	<u>Retirement</u>	<u>Totals</u>
Unadjusted Totals	\$ 1,148,359	\$ 89,308	\$ 517,970	\$ 1,755,637
Less: Commissioners	20,331	1,780	1,320	23,431
Less: Capitalized (2.7%)	- 30,457	- 2,363	- 13,950	- 46,770
Totals	<u>\$ 1,097,571</u>	<u>\$ 85,165</u>	<u>\$ 502,700</u>	<u>\$ 1,685,436</u>

Accordingly, Northern District's proposed adjustment should be denied and employee pensions and benefits expense should be increased by \$100,122, which is \$89,996 less than the adjustment requested by Northern District.

#### Insurance – Auto, General Liability and Workers' Compensation

Northern District reported the following test-period insurance expenses in its pro forma income statement:<sup>40</sup>

<u>Account Title</u>	<u>Expense</u>
Insurance – Vehicle	\$ 67,576
Insurance – General Liability	205,765
Insurance – Workers Comp.	198,853
Insurance – Other	+ 61,520
Total	<u>\$ 533,714</u>

Northern District proposes to increase its test-period expenses by \$39,543 to reflect the insurance premiums that were received and paid in 2003.<sup>41</sup> The Attorney

<sup>40</sup> Response to Item 1 of Commission Staff's Second Set of Interrogatories and Requests for Production of Documents to Northern District issued December 3, 2003.

<sup>41</sup> Northern District's Application, Exhibit N, Schedule 2, Test-Year Operation and Maintenance Expense.

General states that there is an error in Northern District's adjustment and that the correct increase in this expense is \$32,152.<sup>42</sup>

Since the application was compiled, the actual insurance premium information for 2004 has been made available and presented to the Commission.<sup>43</sup> The following are the insurance premiums for the current policy period:

<u>Coverage Description</u>	<u>Invoice Amount</u>	<u>1 Year Premium</u>
Auto, General Liability, & Public Official	\$ 249,829	\$ 249,829
Inland Marine & Property	\$ 140,298	140,298
Crime	\$ 4,359	4,359
Workers Comp. (6 Month Premium)	\$ 100,218	200,436
Pollution & Terrorism (3 Year Premium)	\$ 143,079	+ 47,692
Total		<u>\$ 642,614</u>

Based on this information, the Commission, finds that Northern District's and the Attorney General's proposed adjustments should be denied and that test-period expenses should be increased by \$108,900.

#### Amortization of Rate Case Expense

Northern District proposes to increase test-period operating expenses by \$90,355 to reflect amortizing the cost of Case No. 2002-00105 over 3 years, which was approved by the Commission in that proceeding. Rate case expense for the application filed in this case totaled \$170,752. The Commission finds that test-period expenses should be increased by \$147,272<sup>44</sup> to reflect amortization of the cost of this rate case over 3 years and the amortization of the cost of the prior rate case.

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<sup>42</sup> Post-Hearing Brief of the Attorney General at 2.

<sup>43</sup> Northern District's Hearing Exhibit 2, Estimated Adjustments to Expenses for the Year 2004.

<sup>44</sup> \$170,752 (Cost of Current Case) ÷ 3 Years = \$56,917 + \$90,355 (Amortization Prior Case) = \$147,272.

### Purchased Water

The Attorney General proposes to reduce test-period operating expenses by \$30,008 to eliminate the cost of the water purchased from the city of Newport. According to the Attorney General this is a non-recurring expense and is for services rendered outside the test period.<sup>45</sup> Northern District counters that while it ceased purchasing water from Newport, it incurred the cost of producing a comparable amount of water at the Newport treatment plant. If any adjustment is made, Northern District states that it should be the “profit” that Newport might have factored into its wholesale rate.<sup>46</sup> The Commission is in agreement with the Attorney General that the reported water purchases are non-recurring and are for purchases made prior to the test period. Therefore, operating expenses should be reduced by \$30,008.

### Engineering Fees

The following engineering fees are for services that Northern District<sup>47</sup> does not expect to occur in the future:

<u>Description</u>	<u>Engineering Fees</u>
Ft. Thomas Reservoir Sludge	\$ 7,113
Taylor Mill UV Evaluation	\$ 3,133
Draft KP, Review & Comment	\$ 4,200
Master Plan Addendum	\$ 83,105

Since the engineering fees are for services that are non-recurring and provide a benefit for more than one period, the Commission finds that that they should be

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<sup>45</sup> Brief of the Attorney General at 2-3.

<sup>46</sup> Brief of Northern District at 7-8.

<sup>47</sup> Response to Item 10 of Commission Staff’s Second Set of Interrogatories and Requests for Production of Documents to Northern District issued December 3, 2003.

removed from operating expenses and amortized over their estimated useful lives. The Commission finds that contractual services should be reduced by \$97,551 and that amortization expense should be increased by \$19,928 as follows:

<u>Description</u>	Engineering <u>Fees</u>	Amortization <u>Period</u>	Amortization <u>Expense</u>
Ft. Thomas Reservoir Sludge	\$ 7,113	5	\$ 1,423
Taylor Mill UV Evaluation	3,133	3	1,044
Draft KP, Review & Comment	4,200	5	840
Master Plan Addendum	<u>+ 83,105</u>	5	<u>+ 16,621</u>
Totals	<u>\$ 97,551</u>		<u>\$ 19,928</u>

The following engineering fees were identified by Northern District<sup>48</sup> as capital project costs:

<u>Description</u>	Engineering <u>Fees</u>
Sodium Hypochlorite – Newport	\$ 4,622
Cincinnati Gear Building – Estimate	7,214
Newport WTP Review	18,444
Cost – Opinion Newport Facility	2,667
Polymer Feed Evaluation	2,900
Acid Feed Evaluation	<u>+ 1,600</u>
Total	<u>\$ 37,447</u>

Since these fees are considered construction overhead costs, the Commission finds that they should be removed from test-period expenses and capitalized with the appropriate capital project. Therefore, pro forma operating expenses should be reduced by \$37,447.

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<sup>48</sup> Response to Item 10 of Commission Staff's Second Set of Interrogatories and Requests for Production of Documents to Northern District issued December 3, 2003.

### Cost of Service to Florence and Boone District

In Case No. 2002-00105, Northern District informed the Commission that service to Florence and Boone District would cease in March 2003.<sup>49</sup> To reflect the loss of sales to Boone and Florence, Northern District reduced its operating revenues and expenses. Northern District's proposed adjustment to operating expense was based upon the variable costs of water production of \$.40 per 1,000 gallons, which included purchased power, chemicals, sludge handling, and purchased water. In that proceeding, the Commission found that Northern District's adjustment was reasonable and, therefore, it was accepted.

Northern District proposes to reduce test-period revenues to eliminate the sales for resale to Boone District and Florence, but according to the Attorney General it has failed to remove the corresponding variable operating expenses. The Attorney General argues that Northern District, "[h]as extracted one aspect of the test year without extracting its natural counterpart." For this reason, the Attorney General states that the result is contrary to a basic principle of rate-making (consistency) and the findings in the Commission's Order in Case No. 2002-00105.<sup>50</sup>

Northern District claims that \$0.40 per 1,000 gallons is not the current or an accurate cost of producing water. It states that this number was used for negotiating purposes during discussions to terminate its water service contract and is not based upon the actual cost of treated water.<sup>51</sup> At the hearing, Northern District provided an

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<sup>49</sup> Brief of Northern District at 5.

<sup>50</sup> Post-Hearing Brief of the Attorney General at 1.

<sup>51</sup> T.E. at 32-33.

exhibit showing that the current variable cost of water production at the Fort Thomas treatment plant is \$0.1884 per ccf or \$0.252 per 1,000 gallons.<sup>52</sup> By applying this rate to the test-period water sales to Boone District and Florence, Northern District calculates a decrease in operating expenses of \$680,027.<sup>53</sup>

The Attorney General contends that Northern District was requested to provide the variable cost information during the pre-hearing discovery phase but ignored the request and submitted the evidence at the hearing to the prejudice of the Attorney General. The Attorney General argues that because Northern District failed to offer compelling grounds to change the cost rate used in Case No. 2002-00105 or to demonstrate that the “recalculation” is consistent with the decision in that proceeding, the adjustment to operating expenses should be based upon the \$0.40 per 1,000 gallon rate.<sup>54</sup>

On its Hearing Exhibit 3, Northern District cites the response to a data request of the Attorney General<sup>55</sup> as the source document for the test-period water sales to Florence and Boone District. However, the response to that data request shows water sales to Florence and Boone District of 3,885,765 ccf<sup>56</sup> while Hearing Exhibit 3 indicates water sales of 3,609,488 ccf to Florence and Boone District. Furthermore, upon review

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<sup>52</sup> Northern District’s Hearing Exhibit 3.

<sup>53</sup> Brief of Northern District at 9.

<sup>54</sup> Post-Hearing Brief of the Attorney General at 2.

<sup>55</sup> Response to Item 8 of the Supplemental Responses to the Attorney General filed December 2, 2003.

<sup>56</sup> Boone District  
Add: Florence  
Water Sales

2,504,369 ccf  
+ 1,381,396 ccf  
3,885,765 ccf

of the water treatment costs at the Fort Thomas treatment plant contained in the Cost-of-Service Study, the Commission is unable to replicate Northern District's variable cost calculations on Hearing Exhibit 3.

The evidence presented by Northern District is unclear and contradicts its statements made in Case No. 2002-00105 that the \$0.40 per 1,000 gallon rate, "[i]s the average variable cost to produce water at our Ft. Thomas Treatment Plant."<sup>57</sup> Therefore, Northern District has failed to persuade the Commission that its adjustment in Case No. 2002-00105 is inaccurate or unreasonable.

Using test-period water sales to Florence and Boone District of 3,885,765 ccf or 2,906,751,132 gallons and a variable cost rate of \$.40 per 1,000 gallons, the Commission calculates an adjustment of \$1,162,700. Accordingly, pro forma operating expenses should be decreased by that amount.

#### Depreciation

Test-period depreciation was \$4,768,389. Northern District proposes to decrease that amount by \$115,860 for a proposed pro forma level of depreciation expense of \$4,652,529. In reviewing Northern District's proposed adjustment, the Commission finds that the adjustment is reasonable and should be accepted.

#### Boone/Florence Reserve

Northern District received a reserve fund payment of \$3,700,000 and a termination payment of \$685,842, in accordance with the terms of the Termination Agreement with Florence and Boone District. In Case No. 2002-00105, the

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<sup>57</sup> See Case No. 2002-00105, Response to Item 6 of Commission Staff's First Set of Interrogatories and Requests for Production of Documents to Northern District issued July 29, 2002.

Commission amortized the reserve fund and termination payments over 10 years, which resulted in an increase to test-period income of \$438,584.<sup>58</sup>

In this proceeding, Northern District proposes to increase operating income by \$438,584 to reflect the Commission’s decision in that prior case. The Commission finds that Northern District’s proposed adjustment is reasonable and that it should be accepted.

Summary

Based on the pro forma adjustments found reasonable herein, the Commission finds that Northern District’s pro forma operations should be as follows:

	<u>Test-Period Operations</u>	<u>Pro Forma Adjustments</u>	<u>Pro Forma Operations</u>
Operating Revenues	\$ 28,149,482	\$ 3,980,667	\$ 32,130,149
Operating Expenses	<u>22,825,903</u>	<u>(498,593)</u>	<u>22,327,310</u>
Net Operating Income	\$ 5,323,579	\$ 4,479,260	\$ 9,802,839
Interest Income	984,428	0	984,428
Miscellaneous Income	204,282	0	204,282
Boone & Florence Reserve	<u>0</u>	<u>438,584</u>	<u>438,584</u>
Income Available for Debt Service	<u>\$ 6,512,289</u>	<u>\$ 4,917,844</u>	<u>\$ 11,430,133</u>

REVENUE REQUIREMENT DETERMINATION

Debt Service

Northern District’s proposed debt service of \$10,569,411<sup>59</sup> reflects all debt outstanding at the time the application was prepared, as well as the proposed \$10,455,000 bond issuance. Since filing its application, Northern District has refinanced the 1995 United States Department of Agriculture Bonds (“USDA Bonds”), Series of

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<sup>58</sup> \$3,700,000 (Reserve Balance) + \$685,842 (Termination Fee) = \$ 4,385,842  
 Divided by: Amortization Period ÷ 10 years  
 Annual Amortization \$ 438,584

<sup>59</sup> Northern District’s Application, Exhibit N, Schedule 3, Debt Service.

1993 A, the USDA Bonds, Series of 1995 A, and the USDA Bonds, Series of 1995 B.<sup>60</sup>

By reflecting the savings from Northern District’s bond refinancings, the Commission calculates a debt service of \$10,775,096 as shown in Appendix A.

Revenue Requirement

Based upon the Commission’s findings and determinations herein, Northern District requires an increase in revenues of \$1,499,982, determined as follows:

3 Year Average Debt Service	\$ 10,775,096
Multiplied by: Debt Service Coverage	<u>X 0.2</u>
Coverage	\$ 2,155,019
Add: 3 Year Average Debt Service	10,775,096
Pro Forma Operating Expenses	<u>+ 22,327,310</u>
Total Revenue Requirement	\$ 35,257,425
Less: Interest Income	984,428
Miscellaneous Income	204,282
Boone & Florence – Reserve	<u>- 438,584</u>
Revenue Requirement from Operations	\$ 33,630,131
Less: Other Operating Revenues	<u>- 1,636,079</u>
Revenue Requirement from Water Sales	\$ 31,994,052
Less: Pro Forma Revenue from Water Sales	<u>- 30,494,070</u>
Required Increase	<u>\$ 1,499,982</u>

COST-OF-SERVICE STUDY

Northern District filed with its application a Cost-of-Service Study performed by the engineering firm of Black & Veatch. The study was performed following the procedures recommended by the American Water Works Association (“AWWA”) in its Water Rates Manual M-1 Fifth Edition for the Base-Extra Capacity Method. The Commission recognizes the AWWA Manual M-1 recommendations as proper rate-making procedures for water systems.

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<sup>60</sup> See Case No. 2003-00404, Application of Northern Kentucky Water District for Approval to Refinance Revenue Bonds in the Approximate Amount of \$24,020,000 (December 10, 2003).

The Commission finds that the Cost-of-Service Study is reasonable and should be accepted.

### RATE DESIGN

Northern District's present rate structure consists of differing rate designs as a result of the acquisition of the city of Newport ("Newport"). Northern District customers served in the Newport area receive a service charge that has no volume allowance and a four step declining block commodity charge. Wholesale customers are charged a flat per ccf commodity charge. Northern District proposes to unify rates for all retail customers in its service area. The proposed rates are based on the rate design currently applied to Northern District's retail customers. The proposed rates consist of a service charge by meter size that has no volume allowance and a three step declining block commodity charge. Wholesale customers under the proposed rate structure will continue to be charged a flat per ccf commodity charge.

The proposed rates were developed through the Cost-of-Service Study. The Commission finds that a unified rate is a more equitable method to produce revenues to meet financial needs and associate costs to various customer classes that receive service. Therefore, the Commission accepts Northern District's rate design, but denies the proposed rates because they produce a revenue greater than that found reasonable herein.

### CONCLUSION

Having considered the evidence of record and being otherwise sufficiently advised, the Commission finds that:

1. The proposed Sub-district K project will not compete with any other water utility in the area.

2. The proposed Sub-district K project is necessary to provide service to new areas of rural Kenton County to maintain and extend quality water service to the general area of Kenton County. It is in the public interest and is required to allow Northern District to continue to provide adequate service to its customers.

3. Construction of the proposed Sub-district K project will not result in the wasteful duplication of existing facilities.

4. Public convenience and necessity require the construction of the proposed Sub-district K project.

5. Persons residing within the proposed Sub-district K currently receive water service through cisterns.

6. Northern District proposes to assess each customer of Sub-district K for the next 25 years a monthly surcharge not to exceed \$30. This surcharge is designed to service the debt service of \$130,875 that will be incurred to construct the Sub-district K facilities.

7. The proposed surcharge is reasonable and should be approved subject to the following conditions:

a. The surcharge should continue for no longer than 25 years from the date of this Order or until the collection of the debt incurred to construct the Sub-district K facilities, whichever occurs first.

b. The surcharge proceeds should be used only to finance the facilities that are identified in Northern District's application as Sub-district K facilities.

c. The surcharge should be billed as a separate line item.

d. The surcharge should be adjusted annually to reflect the current number of Sub-district K customers and the outstanding debt service obligations on

Sub-district K facilities. In no event, however, should the level of the surcharge exceed \$30 per month.

e. Northern District should file annual reports with the Commission on Sub-district K surcharge collections, customer levels, and remaining debt service obligations.

f. After the surcharge has been in effect for 5 years, it should be re-examined to determine the extent to which Sub-district K facilities have been integrated into Northern District's overall operations and whether these facilities are benefiting non-Sub-district K customers to the extent that additional adjustments to the surcharge are necessary.

g. In any future general rate adjustment proceeding involving Northern District, no debt attributed to the Sub-district K facilities and financed through the proposed surcharge should be considered when determining Northern District's total revenue requirements.

8. Separate accounts for the billing and collection of surcharge proceeds and for the payment of all debt instruments funded through the surcharge should be maintained.

9. Northern District proposes to fund the \$9.4 million of construction projects outlined in Exhibit O of the application from the issuance of \$10,455,000 in parity revenue bonds that it estimates will have a 25-year term with an effective interest rate that varies from 1.11 to 5.00 percent per annum.

10. The proposed issuance of \$10,455,000 in parity revenue bonds is for lawful objects within Northern District's corporate purposes, is necessary and

appropriate for and consistent with the proper performance by Northern District of its service to the public, and will not impair its ability to perform that service.

11. The rates in Appendix B are the fair, just, and reasonable rates for Northern District and will produce gross annual revenues as found reasonable herein.

12. Northern District's proposed rates would produce revenue in excess of that found reasonable herein and should be denied.

IT IS THEREFORE ORDERED that:

1. Northern District is granted a Certificate to proceed with the proposed construction of Sub-district K as set forth in its application.

2. Northern District shall obtain approval from the Commission prior to performing any additional construction not expressly authorized by this Order.

3. Any deviation from the construction approved shall be undertaken only with the prior approval of the Commission.

4. Northern District shall furnish documentation of the total costs of this project including the cost of construction and all other capitalized costs, (engineering, legal and administrative expenses) within 60 days of the date that construction is substantially completed. Construction costs shall be classified into appropriate plant accounts in accordance with the Uniform System of Accounts for water utilities prescribed by the Commission.

5. Northern District shall file with the Commission a copy of the "as-built" drawings and a certified statement that the construction has been satisfactorily completed in accordance with the contract plans and specifications within 60 days of the substantial completion of the construction certificated herein.

6. Northern District shall require construction to be inspected under the general supervision of a licensed professional engineer with a Kentucky registration in civil or mechanical engineering, to ensure that the construction work is done in accordance with the contract drawings and specifications and in conformance with the best practices of the construction trades involved in the project.

7. Northern District shall notify the Commission 7 days prior to the actual start of construction and at the 50 percent completion point.

8. Northern District is authorized to assess each customer of Sub-district K a monthly surcharge of \$30 subject to the conditions set forth in Ordering Paragraphs 9 through 17.

9. Northern District shall cease collection of the surcharge 25 years from the date of this Order or until the collection of the debt incurred to construct the Sub-district K facilities, whichever occurs first.

10. The surcharge proceeds shall be used only to finance the facilities that are identified in Northern District's application as Sub-district K facilities and that the Commission has approved in this Order.

11. Northern District shall identify the surcharge as a separate line item on its bills to Sub-district K customers.

12. On April 1, 2005, and each year thereafter so long as Northern District assesses the surcharge, Northern District shall adjust the surcharge level to reflect the number of Sub-district K customers as of December 31 of the preceding year and the outstanding debt service requirements on the debt that was issued to finance the Sub-district K facilities approved herein. In no event, however, shall the level of the surcharge exceed \$30 per month.

13. Beginning in 2005, for the period from the date of this Order until December 31, 2004, and for each calendar year thereafter in which the surcharge is effective, Northern District shall submit with the annual financial and statistical report required by 807 KAR 5:006, Section 3(1), a written report stating:

- a. the number of customers in Sub-district K as of December 31 of the preceding year.
- b. the total surcharge billed during the preceding calendar year.
- c. the total surcharge billed since the date of this Order.
- d. the remaining debt service on the debt instruments issued to finance the Sub-district K facilities approved herein.

14. In its written report submitted for calendar year 2010, Northern District shall describe how Sub-district K facilities have been integrated into Northern District's overall operations, shall list and describe the benefits, if any, that Sub-district K facilities provide to non-Sub-district K customers, and shall state whether further adjustments to the surcharge are necessary to reflect these benefits.

15. Northern District shall for accounting purposes maintain separate accounts for the billing and collection of surcharge proceeds and for the payment of all debt instruments funded through the surcharge.

16. Northern District shall maintain a current description of Sub-district K in its filed rate schedules so long as the Sub-district K surcharge is effective.

17. All persons who receive water service through the Sub-district K facilities or through water mains that are laterals to or extensions of those facilities shall be

considered within Sub-district K and shall be assessed the surcharge. Such surcharge, however, shall not be assessed to any person served through any existing sub-district.

18. Northern District is authorized to issue approximately \$10,455,000 in parity revenue bonds.

19. The proceeds of the issuance authorized herein shall be used only for the purposes set forth in Northern District's application.

20. Northern District's proposed rates are denied.

21. The rates set forth in Appendix B are approved for service rendered by Northern District on and after the date of this Order and will produce gross annual revenues as found reasonable herein.

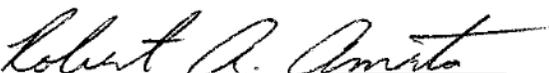
22. Within 30 days from the date of this Order, Northern District shall file with this Commission revised tariff sheets setting out the rates and charges approved herein.

Nothing contained herein shall be deemed a warranty or finding of value of securities or financing authorized herein on the part of the Commonwealth of Kentucky or any agency thereof.

Done at Frankfort, Kentucky, this 14<sup>th</sup> day of June, 2004.

By the Commission

ATTEST:

  
DEPUTY Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 2003-00224 DATED June 14, 2004

DEBT SERVICE AS DETERMINED BY THE COMMISSION

<u>Bond Title</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Series 1997	\$ 1,087,358	\$ 1,086,990	\$ 1,089,860
Series 1998	721,999	720,836	724,080
2000 USDA	135,600	134,400	135,150
Series 2001 A	981,325	963,100	940,313
Series 2002 A	2,537,403	2,536,540	2,530,115
Series 2002 B	825,881	846,706	871,406
Series 2003 A	100,529	100,078	99,531
Series 2003 B	2,058,200	1,884,150	1,882,100
Series 2003 C	1,941,129	1,907,944	1,904,544
Proposed Bonds	+ 182,251	+ 700,256	+ 695,513
Totals	<u>\$ 10,571,675</u>	<u>\$ 10,881,000</u>	<u>\$ 10,872,612</u>

2004	\$ 10,571,675
2005	10,881,000
2006	+ 10,872,612
Subtotal	\$ 32,325,287
Divide by: 3 Years	÷ 3 Years
3 Year Average Debt Service	<u>\$ 10,775,096</u>

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 2003-00224 DATED June 14, 2004

The following rates and charges are prescribed for the customers in the area served by Northern 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.

<u>Meter Size</u>	<u>Service Charges</u>	
	<u>Monthly</u>	<u>Quarterly</u>
5/8"	\$ 10.33	\$ 15.37
3/4"	\$ 10.68	\$ 16.16
1"	\$ 11.61	\$ 18.53
1 1/2"	\$ 13.05	\$ 21.72
2"	\$ 16.38	\$ 30.36
3"	\$ 38.84	\$ 93.42
4"	\$ 48.63	\$ 117.14
6"	\$ 72.03	\$ 172.60
8"	\$ 97.18	\$ 235.61
10"	\$ 129.43	\$ 307.44

	<u>Commodity Charges</u>		<u>Rates</u>
	<u>Monthly Block</u>	<u>Quarterly Block</u>	
	ccf	ccf	
First	15	45	\$ 2.63 per ccf
Next	1,635	4,905	\$ 2.23 per ccf
Over	1,650	4,950	\$ 2.08 per ccf
Wholesale			\$ 1.80 per ccf