

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF THE BULLOCK PEN WATER)	
DISTRICT FOR A CERTIFICATE OF PUBLIC)	
CONVENIENCE AND NECESSITY TO)	
CONSTRUCT AND FINANCE AN)	CASE NO. 2004-00339
IMPROVEMENTS PROJECT AND TO)	
IMPLEMENT A SURCHARGE TO ITS EXISTING)	
RATES PURSUANT TO KRS 278.020 AND)	
278.300)	

ORDER

On August 31, 2004, Bullock Pen Water District (“Bullock Pen”) tendered an application for a Certificate of Public Convenience and Necessity to construct a \$362,300 waterworks improvement project (“Phase VII”), for approval of its plan of financing the project, and for approval of a surcharge. The Commission accepted this application on September 15, 2004 after the utility cured certain filing deficiencies.

Phase VII, as described in Bullock Pen’s application, consists of 2.6 miles of 8-inch water line with appurtenances with a total estimated cost of \$372,042.¹ In its application, Bullock Pen proposed to finance the construction through customer connection fees in the amount of \$19,475, a contribution from Boone County Fiscal Court in the amount of \$120,767, a Kentucky Infrastructure Authority (“KIA”) 2020 grant in the amount of \$128,800, and a loan of \$103,000 from the Kentucky Rural Water Finance Corporation (“KRWFC”). Bullock Pen estimates that approximately 75 new

¹ Construction Costs	\$362,300.00
Financing Costs	<u>9,742.00</u>
Total Cost	<u>\$372,042.00</u>

customers may eventually be served through Phase VII.² Bullock Pen reports that 41 households have already executed contracts for water service.³

In its application, Bullock Pen stated that its proposed loan with KRWFC had a term of 12 years and a flexible interest rate ranging from 1.68 to 4.27 percent.⁴ It subsequently restated the amount of the loan as \$98,000, the loan's term as 15 years, and its interest rates as ranging from 3.12 to 4.12.⁵ The net financing costs were restated at \$4,742 leaving \$93,258 to be deposited to the project construction fund.⁶

Bullock Pen requested authority to assess a \$20 monthly surcharge to those customers receiving service through Phase VII construction ("limited surcharge") until the KRWFC loan is retired. It calculated the proposed limited surcharge based on the loan terms stated in its application and the assumption that only 41 customers would be served through the proposed extension.

The Commission is of the opinion that the most appropriate means to recover the costs of water main extension projects is through general rates. We have, however, previously approved limited surcharges for other water utilities including Bullock Pen.⁷

² Bullock Pen's Response to Commission Staff's First Data Request, Item 12; but see Application at ¶6 (in which Bullock Pen states 90 customers will be served.)

³ Bullock Pen's Response to Commission Staff's First Data Request, Item 12.

⁴ Application, Exhibit B at 2.

⁵ Bullock Pen's Response to Commission Staff's First Data Request, Item 1, Exhibit A at 2.

⁶ Id. at 1.

⁷ See, e.g., Case No. 2002-00015, Application of the Bullock Pen Water District for a Certificate of Public Convenience and Necessity to Construct and Finance an Improvements Project and to Implement a Surcharge to Its Existing Rates Pursuant To KRS 278.020 and 278.300 (Ky. PSC Mar. 18, 2002).

In those cases, the Commission has considered additional revenues that will be generated as a result of new customers. We determine the additional net revenues per customer of each new customer added to the system through the proposed construction. This net revenue is then used to offset the annual principal and interest payments of the new debt leaving only a portion of that debt for which a surcharge would be necessary to retire. We find no evidence in the record of this proceeding to suggest that use of this methodology in the case at bar is inappropriate or unreasonable. We further find that any surcharge to finance the payment of the KRWFC loan should be calculated to credit prospective customers for the net revenue that they will contribute to Bullock Pen.

In applying this methodology to the current case, the Commission has used pro forma financial information rather than historical financial information. Bullock Pen has provided a pro forma income statement⁸ based upon its audited 2003 financial report and adjusted to reflect annualized revenues from recently reestablished rates⁹ and changes in operating revenues, expenses and debt payments resulting from recent construction projects and debt issuances and the proposed construction and financing of Phase VII. Since the surcharge to finance the KRWFC loan should be based on net revenues generated from existing customers, the Commission has removed from Bullock Pen's pro forma income statement all adjustments related to Phase VII. Using

⁸ Id. at Item 3.

⁹ Case No. 2003-00164, The Application of Bullock Pen Water District Requesting: (1) A Certificate of Public Convenience and Necessity Authorizing Construction of Major Additions and Improvements to its Water System; (2) Seeking Approval of Revised Water Service Rates and Charges; (3) Seeking Approval of Financing Pursuant to KRS 278.020 and KRS 278.300 (Ky. PSC Dec. 3, 2003).

this statement and based upon the calculations set forth in Table 1, the Commission finds that the appropriate level for a monthly surcharge to assess customers served through Phase VII is \$12.52.

Table I

Pro Forma Metered Sales	\$ 2,456,776.00
Less: To Be Collected from Phase VII	(16,367.07)
Add: Forfeited Discounts	39,586.00
Miscellaneous Revenue	37,054.00
	\$ 2,517,048.93
Pro Forma Operating Revenue Net of Phase VII	\$ 2,517,048.93
Pro Forma Operating Expenses	2,202,106.00
Less: Purchased Water for Phase VII	(6,178.00)
Depreciation for Phase VII	(7,246.00)
	(2,188,682.00)
Less: Pro Forma Operating Expenses Net of Phase VII	(2,188,682.00)
Pro Forma Net Operating Income Net of Phase VII	328,366.93
Divide by: Number of Customers excluding Phase VII	5,779.00
	56.82
Pro Forma Net Earnings per Customer Net of Phase VII	56.82
Times: Number of Customers to be added immediately through Phase VII	41.00
	2,329.62
Annual Earnings from Phase VII to be applied to Surcharge Debt	\$ 2,329.62
Average Annual Debt Payment of Proposed Loan (\$127,346.60 / 15 yrs)	\$ 8,489.77
Less: Applied Earning	(2,329.62)
	6,160.15
Annual Debt to be Recovered through Surcharge Collections	6,160.15
Divide by: Number of Customers	41.00
12 Months	12.00
	12.52
Monthly per Customer Surcharge	\$ 12.52

The surcharge is based upon the assumption that only the 41 customers will be served through Phase VII. Potentially 34 additional customers could receive water service through Phase VII. As the addition of new customers would affect the revenue generated through the surcharge, the Commission finds that Bullock Pen should recalculate the surcharge amount annually to reflect customer growth. To reduce the

complexity of such recalculation, Bullock Pen should apply the calculation shown in Table I adjusting only the number of Phase VII customers.

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

1. Bullock Pen proposes to construct 2.6 miles of 8-inch water line with appurtenances along McCoy Fork Road in Boone County, Kentucky.

2. The proposed water main extension may potentially serve 75 households. Approximately 41 households in the area that the proposed water main extension will serve have executed contracts for water service.

3. No other water utility presently provides water service to the area that the proposed water main extension will serve.

4. Persons currently residing in the area that the proposed water main extension will serve currently use cisterns and bottled water for their water needs.

5. Total estimated cost of the proposed water main extension is \$367,042.

6. The proposed water main extension will be funded through customer connection fees of \$19,475, a contribution of \$120,767 from Boone County Fiscal Court, a KIA 2020 grant of \$128,800, and a loan of \$98,000 from the KRWFC.

7. CMW, Inc. of Richmond, Kentucky, prepared the plans and specifications for the proposed improvements.

8. The Division of Water of the Kentucky Environmental and Public Protection Cabinet has approved the plans and specifications for the proposed water main extension.

9. The public convenience and necessity require the proposed water main extension.

10. Bullock Pen's proposed loan of \$98,000 from the KRWFC is for lawful objects within the corporate purpose of Bullock Pen's utility operation, is necessary and appropriate for and consistent with the proper performance of Bullock Pen's service to the public and will not impair Bullock Pen's ability to perform that service, is reasonably necessary and appropriate for such purpose, and should be approved.

11. The proposed monthly surcharge of \$20 will generate revenues in excess of that necessary to meet the debt service on the proposed KRWFC loan, is unreasonable, and should be denied.

12. A monthly surcharge of \$12.52 on customers who receive water service through the proposed water main extension is reasonable and should be approved subject to the following conditions:

a. The surcharge should cease 15 years from the date of this Order, upon Bullock Pen's satisfaction of all repayment obligations under its loan agreement with KRWFC or when the Commission otherwise orders.

b. The surcharge proceeds should be used only to satisfy Bullock Pen's obligations under its loan agreement with KRWFC.

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

d. The surcharge should be adjusted annually to reflect the current number of customers who receive water service through the Phase VII water main extension project. In no event, however, should the level of the surcharge exceed \$12.52 per month.

e. Bullock Pen should file annual reports with the Commission on Phase VII surcharge collections, customer levels, and remaining debt service obligations.

f. 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.

IT IS THEREFORE ORDERED that:

1. Bullock Pen is granted a Certificate of Public Convenience and Necessity to proceed with the proposed construction project as set forth in the plans and specifications of record herein.

2. Bullock Pen 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. Bullock Pen shall furnish documentation of the total costs of this project including the cost of construction and all other capitalized costs (engineering, legal, administrative, etc.) within 60 days of the date that construction is substantially completed. Construction cost should be classified into appropriate plant accounts in accordance with the Uniform System of Accounts ("USoA") for Water Utilities prescribed by the Commission.

5. Bullock Pen 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.

6. Bullock Pen shall notify the Commission in writing 7 days prior to the actual commencement of the proposed construction and when 50 percent of the proposed construction is completed.

7. Bullock Pen shall file 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.

8. Bullock Pen is authorized to enter into a loan agreement with KRWFC for \$98,000 with a term of 15 years and a variable interest rate ranging from 3.12 to 4.12 percent.

9. The proceeds of Bullock Pen's loan agreement with KRWFC shall be used only for the lawful purposes specified in Bullock Pen's application.

10. Bullock Pen's proposed monthly surcharge of \$20 on customers who receive water service through the proposed Phase VII water main extension project is denied.

11. Bullock Pen is authorized to assess a monthly surcharge of \$12.52 on customers who receive water service through the proposed Phase VII water main extension project. The surcharge shall cease 15 years from the date of this Order, upon Bullock Pen's satisfaction of all repayment obligations under its loan agreement with KRWFC or when the Commission otherwise orders.

12. On May 1, 2006, and each year thereafter so long as Bullock Pen assesses the surcharge, it shall adjust the surcharge level using the same net revenue formula as included in this Order to reflect the number of customers as of December 31 of the preceding year who receive water service through the Phase VII water main

extension project. In no event, however, shall the level of the surcharge exceed \$12.52 per month.

13. At least 30 days prior to adjusting the surcharge amount, Bullock Pen shall file with the Commission a revised tariff sheet that includes the restated surcharge amount and that conforms to the requirements of Administrative Regulation 807 KAR 5:011. Bullock Pen shall file with such sheet all calculations that support the restated amount.

14. Bullock Pen shall identify the surcharge as a separate line item on its bills to all affected customers.

15. Beginning in 2006, for the period from the date of this Order until December 31, 2005, and for each calendar year thereafter in which the surcharge is effective, Bullock Pen shall submit with the annual financial and statistical report required by Administrative Regulation 807 KAR 5:006, Section 3(1), a written report stating

a. the number of customers who receive water service through the proposed Phase VII water main extension project 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 loan with KRWFC approved

herein.

16. All payments made by customers who receive water service through the proposed Phase VII water main extension project shall first be applied toward the surcharge before being applied to Bullock Pen's general operations.

17. The surcharge proceeds shall be used only to satisfy the debt service obligations imposed by the loan agreement between Bullock Pen and KRWFC approved herein.

18. Bullock Pen shall account for all construction costs in accordance with the USoA Accounting Instruction 20.

19. Within 30 days of the date of this Order, Bullock Pen shall file with the Commission its revised tariff sheet setting out the surcharge approved herein. The revised tariff sheet shall state the amount of the surcharge and a complete description of the customers to which it is to be assessed.

20. All other rates and charges of Bullock Pen shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

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

Done at Frankfort, Kentucky, this 14th day of February, 2005.

By the Commission

ATTEST:


Executive Director