

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 IMPROVEMENT) CASE NO. 2005-00231
PROJECTS AND TO IMPLEMENT SURCHARGES)
TO ITS EXISTING RATES PURSUANT TO KRS)
278.020 AND 278.300)

ORDER

Bullock Pen Water District (“Bullock Pen”) has applied for a Certificate of Public Convenience and Necessity to construct two water main extension projects, authority to enter into the proposed loan agreements with the Kentucky Rural Water Finance Corporation (“KRWFC”) to borrow \$804,000 to finance these main extensions, and authority to assess separate surcharges to customers who receive water service through these main extensions.¹ By prior Order, the Commission issued the Certificate and authorized Bullock Pen to enter the proposed loan agreements.²

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

¹ Bullock Pen tendered its application to the Commission on June 17, 2005. The Commission did not accept the application for filing until July 14, 2005, when Bullock Pen had corrected certain deficiencies in its submission. No party has intervened in this proceeding. On August 9, 2005, Commission Staff propounded requests for information to Bullock Pen. The water district responded to these requests on August 25, 2005.

² Order of August 17, 2005.

1. Bullock Pen, a water district organized under KRS Chapter 74, provides retail water service to approximately 5,873 customers in Boone, Gallatin, Grant, Kenton and Pendleton counties, Kentucky.³

2. Bullock Pen proposes to construct two water main extension projects – Phase 8 and Phase 10 Water Main Extensions.

3. The Phase 8 Water Main Extension involves the construction and installation of approximately 21.75 miles of 8-inch, 6-inch, and 2-inch water main in Grant County, Kentucky. Bullock Pen estimates that this extension will provide water service to approximately 173 households.

4. The estimated cost of the Phase 8 Water Main Extension is \$1,886,000. Bullock Pen will finance this cost with a Kentucky Infrastructure Authority (“KIA”) Tobacco Grant of \$725,500, a KIA Grant of \$600,000, customer tap-on fees of \$66,500, and a KRWFC loan of \$514,000.

5. The Phase 10 Water Main Extension involves the construction and installation of approximately 7.9 miles of 8-inch water main in Boone County, Kentucky. Bullock Pen estimates that this project will provide water service to approximately 152 households.

6. The estimated cost of the Phase 10 Water Main Extension is \$926,800. Bullock Pen proposes to finance this cost with a KIA Grant of \$300,000, a KRWFC loan of \$290,000, a contribution of \$308,933 from Boone County Fiscal Court, and customer tap-on fees of \$39,115.

³ Annual Report of Bullock Pen Water District to the Public Service Commission for the Calendar Year Ended December 31, 2004 at 27.

7. Bullock Pen proposes to assess a monthly surcharge of \$15 on customers who receive water service through the Phase 8 Water Main Extension and a monthly surcharge of \$14.37 on customers who receive water service through the Phase 10 Water Main Extension and to use the proceeds of these surcharges to meet the debt service requirements of the KRWFC loans.

8. To calculate the proposed surcharges, Bullock Pen determined the annual debt service requirement of each KRWFC loan. Assuming that 140 customers would be served through the Phase 8 Water Main Extension and 82 customers would be served through the Phase 10 Water Main Extension and that each of these customers would generate additional annual net revenue of \$56.82, Bullock Pen then calculated the net operating income from general rates that would be generated by the customers who these projects would serve. Bullock Pen then reduced each required annual debt service amount by these additional annual net revenues to determine the total amount that each surcharge must generate annually and divided this amount divided by the number of customers who are served through the respective project. Its calculations are reflected in Table I below.

TABLE I		
	Phase 8	Phase 10
Number of Customers	140	82
Pro forma net operating income per customer	\$ 56.82	56.82
Net operating income from general rates to be derived from surcharged customers	<u>\$ 7954.80</u>	<u>\$ 4659.24</u>
Total annual debt service requirement	\$33,348.00	\$18,798.76
Less: Net operating income from general rates to be derived from surcharged customers	<u>\$ (7,954.80)</u>	<u>\$ (4,659.24)</u>
Debt Service to be collected through surcharge	\$25,393.20	\$14,139.52
Divided by: Number of surcharged customers	<u>140</u>	<u>82</u>
Annual Surcharge Collected from Customer	\$ 181.38	\$ 172.43
Divided by: 12 months	<u>12</u>	<u>12</u>
Monthly surcharge ⁴	<u>\$ 15.12</u>	<u>\$ 14.37</u>

⁴ Bullock Pen has rounded the amount of the surcharge to the nearest dollar.

9. The most appropriate means to recover the cost of water main extension projects is through general rates. The Commission, however, has previously approved the use of surcharges on the customers who benefit from a water main extension project to finance the cost of such project.⁵ When establishing the level of the surcharge in those cases, the Commission has considered additional revenues that will be generated as a result of the new customers. There is no evidence in the record of this proceeding to suggest that use of this methodology in the case at bar is inappropriate or unreasonable.

10. Bullock Pen's assumptions of 140 customers for the Phase 8 Water Main Extension and 82 customers for the Phase 10 Water Main Extension are reasonable. As of August 23, 2005, only 140 persons had executed written agreements to receive water service through the proposed Phase 8 Water Main Extension and only 82 persons had executed written agreements to receive water service through the proposed Phase 10 Water Main Extension.⁶

11. Bullock Pen's assumption that each customer of the Phase 8 and Phase 10 Water Main Extensions will generate additional net operating income of \$56.82 is based upon dated financial information. In Case No. 2004-00339⁷ the Commission

⁵ 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); Case No. 2004-00339, 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 Feb. 14, 2005).

⁶ Bullock Pen's Response to Commission Staff's Interrogatories and Requests for Production of Documents, Items 1 and 2.

⁷ Case No. 2004-00339, Order of Feb. 14, 2005 at 3 - 4.

determined that Bullock Pen's net operating income per customer was \$56.82 based upon its operations for the calendar year ended December 31, 2003. Based upon the information contained in Bullock Pen's Annual Report for the calendar year ended December 31, 2004, its net operating income per customer is currently \$100.65.⁸

12. Absent unusual circumstances, the most current financial information should be used to calculate the level of any surcharge. Failure to use such information is unreasonable and is likely to result in an unreasonable rate.⁹

13. Assuming that each customer of the Phase 8 and Phase 10 Water Main Extension Projects generates additional annual net revenue of \$100.65, the appropriate monthly surcharge for persons served through the Phase 8 and Phase 10 Water Main Extensions should be \$11.46 and \$10.72, respectively. The calculation of these surcharges is shown in Table II.

⁸ Average Net Operating Income Per Customer = Net Operating Income ÷ Number of Customers at Year End = \$591,139 ÷ 5,873 = \$100.65. See Annual Report at 11.

⁹ Bullock Pen argues that its net operating income per customer should not be calculated based upon its Calendar Year 2004 operations. That year of operations reflects the first full year of revenue from a recent general rate adjustment and is, in Bullock Pen's opinion, the year in which the utility will experience its highest net operating income per customer. Bullock Pen further asserts that this level will likely fall in succeeding years and, as the KRWFC loans will be repaid over a 25-year period, not likely to reflect net operating income per customer in future years. See Bullock Pen's Response to Commission Staff's Interrogatories and Requests for Production of Documents, Item 4(b).

The Commission finds no merit to this argument. No extraordinary or non-recurring items are included in the calculation of Bullock Pen's 2004 operating income. Id. at Item 5. Moreover, Bullock Pen's argument assumes no further rate adjustments will be requested or granted in succeeding years. While a utility's net operating income may decrease with each succeeding year following a general rate adjustment as the level of expenses increases, it is management's responsibility to seek appropriate rate adjustments to maintain the financial soundness of the utility. These adjustments are likely to restore Bullock Pen's net operating income per customer to the levels experienced in 2004.

TABLE II		
	Phase 8	Phase 10
Number of Customers	140	82
Pro forma net operating income per customer	\$ 100.65	\$ 100.65
Net operating income from general rates to be derived from surcharged customers	<u>\$14,091.00</u>	<u>\$ 8,253.30</u>
Total annual debt service requirement	\$33,348.00	\$18,798.76
Less: Net operating income from general rates to be derived from surcharged customers	<u>\$(14,091.00)</u>	<u>\$ (8,253.30)</u>
Debt Service to be collected through surcharge	\$19,257.60	\$10,545.46
Divided by: Number of surcharged customers	<u>140</u>	<u>82</u>
Annual Surcharge Collected from Customer	\$ 137.55	\$ 128.60
Divided by: 12 months	<u>12</u>	<u>12</u>
Monthly surcharge	<u>\$ 11.46</u>	<u>\$ 10.72</u>

14. The proposed monthly surcharges of \$15 and \$14.37 for customers who receive water service through the Phase 8 and Phase 10 Water Main Extensions, respectively, will generate more revenues than necessary to meet the purpose of the surcharges, are unreasonable, and should be denied.

15. Monthly surcharges of \$11.46 for customers served through the Phase 8 Water Main Extension (“Phase 8 Surcharge”) and of \$10.72 for persons served through the Phase 10 Water Main Extension (“Phase 10 Surcharge”) are reasonable and should be approved subject to the following conditions:

a. The Phase 8 Surcharge should cease 25 years from the date of this Order or upon Bullock Pen’s satisfaction of all repayment obligations under the loan agreement with KRWFC to borrow \$514,000. The Phase 10 Surcharge should cease 25 years from the date of this Order or upon Bullock Pen’s satisfaction of all repayment obligations under the loan agreement with KRWFC to borrow \$290,000. Upon reasonable notice to Bullock Pen, the Commission may order termination of either or both surcharges at any earlier date.

b. The proceeds of each surcharge should be used only to service the debt instruments that Bullock Pen issued to finance the respective water main extension project.

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

d. Each surcharge should be adjusted annually to reflect the current number of customers who receive water service through its respective water main extension project. In no event, however, should the level of the Phase 8 Surcharge exceed \$11.46 per month or the level of the Phase 10 Surcharge exceed \$10.72 per month.¹⁰

e. Bullock Pen should file annual reports with the Commission on Phase 8 and Phase 10 Surcharges 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.

g. In any future general rate adjustment proceeding involving Bullock Pen, no debt attributed to the Phase 8 and Phase 10 Water Main Extensions and financed through the approved surcharges should be considered when determining bullock Pen's total revenue requirements.

¹⁰ Bullock Pen proposes that this review occur every 60 months. See Application at 5 and 9. Given the effect of the addition of a small number of customers on the surcharge level, we find that Bullock Pen should perform this review annually instead.

IT IS THEREFORE ORDERED that:

1. Bullock Pen's proposed monthly surcharges of \$15 and \$14.37 for customers who receive water service through the Phase 8 and Phase 10 water main extension projects are denied.

2. Bullock Pen is authorized to assess each customer who is served through the Phase 8 water main extension project a monthly surcharge of \$11.46 subject to the conditions set forth in Ordering Paragraphs 4 through 14.

3. Bullock Pen is authorized to assess each customer who is served through the Phase 10 water main extension project a monthly surcharge of \$10.72 subject to the conditions set forth in Ordering Paragraphs 4 through 14.

4. Bullock Pen shall cease collection of the Phase 8 Surcharge 25 years from the date of this Order or upon Bullock Pen's satisfaction of all obligations under its agreement with KRWFC to borrow \$514,000, whichever occurs first. Upon reasonable notice to Bullock Pen, the Commission may order termination of the Phase 8 Surcharge at an earlier date.

5. Bullock Pen shall cease collection of the Phase 10 Surcharge customers 25 years from the date of this Order or upon Bullock Pen's satisfaction of all obligations under its agreement with KRWFC to borrow \$290,000, whichever occurs first. Upon reasonable notice to Bullock Pen, the Commission may order termination of the Phase 10 Surcharge at an earlier date.

6. On May 1, 2007, and each year thereafter so long as Bullock Pen assesses each surcharge, it shall adjust the level of each surcharge 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 respective

water main extension projects. In no event, however, shall the level of the Phase 8 Surcharge exceed \$11.46 per month or the level of the Phase 10 Surcharge exceed \$10.72 per month.

7. At least 30 days prior to adjusting either surcharge amount, Bullock Pen shall file with the Commission a revised tariff sheet that includes the restated surcharge amount(s) 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(s).

8. Bullock Pen shall deposit the proceeds of each surcharge in separate reserve trust accounts and invest the proceeds until they are needed only in securities or instruments that the United States government issues or guarantees. The proceeds of each surcharge, together with any interest or other earnings from the trust account, shall be used only to service the debt instruments that Bullock Pen issued to finance the respective water main extension project.

9. Bullock Pen shall identify the surcharge as a separate line item on its bills to customers who are served through the Phase 8 or Phase 10 water main extension projects.

10. Beginning in 2007, for the period from the date of this Order until December 31, 2006, 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 on the Phase 8 and Phase 10 surcharges stating:

- a. the number of customers as of December 31 of the preceding year that received water service through the Phase 8 and Phase 10 Water Main Extensions, respectively;
- b. the total surcharge billed for each surcharge during the preceding calendar year;
- c. the total surcharge billed for each surcharge since the date of this Order;
- d. the remaining debt service on each of the debt instruments that the proceeds from the Phase 8 and Phase 10 Surcharges are intended to service and that this Commission has previously approved.

11. All payments made by customers who receive water service through the Phase 8 and Phase 10 water main extensions shall first be applied toward the respective surcharge before being applied to Bullock Pen's general operations.

12. Within 20 days of the date of this Order, Bullock Pen shall revise its filed rate schedules to contain the approved surcharges and a description of the areas that are subject to these surcharges. At a minimum, this description shall include a map of the general area and a listing of all streets and roadways subject to the respective surcharge.

13. Bullock Pen shall maintain a current description of areas subject to the approved surcharges in its filed rate schedules so long as these surcharges are effective.

14. All persons who receive water service through the Phase 8 or Phase 10 water main extensions or through water mains that are laterals to or extensions of those facilities shall be assessed the respective surcharge.

Done at Frankfort, Kentucky, this 12th day of December, 2005.

By the Commission

ATTEST:

A handwritten signature in black ink, consisting of several overlapping loops and flourishes, positioned above a horizontal line.

Executive Director