

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

| | | |
|--------------------------------|---|------------|
| THE APPLICATION OF THE |) | |
| CRITTENDEN-LIVINGSTON COUNTY |) | |
| WATER DISTRICT FOR APPROVAL OF |) | |
| A PROPOSED INCREASE IN RATES |) | CASE NO. |
| FOR WATER SERVICE, TO INCREASE |) | 2005-00355 |
| NON-RECURRING CHARGES AND TO |) | |
| REVISE ITS TARIFF |) | |

O R D E R

On September 29, 2005, Crittenden-Livingston County Water District ("Crittenden-Livingston") filed its application for Commission approval of its proposed water rates. Commission Staff, having performed a limited financial review of Crittenden-Livingston's operations, has prepared the attached Staff Report containing Staff's findings and recommendations regarding the proposed rates. All parties should review the report carefully and provide any written comments or requests for a hearing or informal conference no later than 10 days from the date of this Order.

IT IS THEREFORE ORDERED that all parties shall have no more than 10 days from the date of this Order to provide written comments regarding the Staff Report or requests for hearing or informal conference. If no request for a hearing or informal conference is received, this case will be submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this 20th day of December, 2005.

By the Commission

ATTEST:


Executive Director

STAFF REPORT
ON
CRITTENDEN-LIVINGSTON COUNTY WATER DISTRICT
CASE NO. 2005-00355

On September 29, 2005, Crittenden-Livingston County Water District ("Crittenden-Livingston") filed its application for Commission approval of its proposed water rates. Commission Staff ("Staff") performed a limited financial review of Crittenden-Livingston's test year operations for the calendar year ending December 31, 2004. Staff's review was performed on September 28, 2005. The scope of Staff's review was limited to obtaining information as to whether the test period operating revenues and expenses were representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

Commentary

In recent years, Crittenden-Livingston's water system has expanded at a substantial rate. According to its most recent PSC Annual Report, Crittenden-Livingston had total utility plant of \$20,210,456 at the end of 2004, and more than 60 percent of that plant has been or is being added in three major construction projects approved by the PSC within the past five years. The additional debt associated with these projects has required Crittenden-Livingston to request three rate increases since 2000, including the present instance. In this case, Crittenden-Livingston proposes a revenue increase of \$517,792 or 35 percent. This proposal would increase the water bill for a residential customer using 5,000 gallons from \$40.94 to \$50.40. Crittenden-Livingston's application suggests that its average usage is only 3,500 gallons, but nevertheless the

District's water rates in recent years have become much higher than the average rate for PSC-regulated water utilities.

Assuming that Crittenden-Livingston's 2004 revenues and expenses are representative of ongoing operations, the rate increase if fully granted still would not allow the District sufficient revenues to fully fund depreciation and meet all ongoing operating expenses. Therefore, unless Crittenden-Livingston implements significant cost controls, future rate increases may well be necessary, especially if the District continues to expand. As well, the District has advised Staff that customer participation rates in expansion projects are somewhat low. Given this situation, Staff suggests that the District carefully evaluate the economics of future expansion projects to ensure that its customers' water bills remain affordable.

In its application, Crittenden-Livingston requested expedited approval of its proposed rate increase, stating that without an increase, it would be unable to make debt payments to the Kentucky Rural Water Finance Corporation, the first of which is due on January 1, 2006. However, Crittenden-Livingston's application also disclosed several issues related to needed improvements in bookkeeping, auditing, and internal controls – issues which were underscored by the firing of an employee due to the theft of District assets. At the time of Staff's field review, the situation was being investigated by the Kentucky State Police, and financial records normally reviewed by Staff to develop revenue requirements were unavailable from the District.

On November 10, 2005, Staff visited the offices of the Kentucky State Police in an attempt to review Crittenden-Livingston's test-period invoices. However, Staff was unable to locate these invoices from the Kentucky State Police or elsewhere.

Therefore, Staff's evaluation of Crittenden-Livingston's proposed pro forma operations is based upon the fact that a few expense categories constitute a majority of Crittenden-Livingston's revenue requirement, and in and of themselves justify the need for the proposed increase. Specifically, Crittenden-Livingston's proposed revenue increase of \$517,792 when added to its normalized revenues of \$1,521,722 results in a proposed revenue requirement of \$2,039,514. Of that amount, Crittenden-Livingston's debt service coverage constitutes \$1,074,019, or more than half of the proposed revenue requirement. Adding 2004 depreciation expense of \$369,820 and 2004 employee-related costs - \$308,340 for salaries and wages, \$52,393 for retirement contributions, and \$23,558 for FICA taxes - results in \$1,932,149 in costs before all other expenses or pro forma adjustments are factored in, including purchased power, chemicals, insurance, materials and supplies, contractual services, and other expenses. These other expenses totaled \$475,850 for 2004, and most of them would have to be disallowed to justify any reduction in the amount of increase recommended for Crittenden-Livingston if proposed debt service, employee-related costs, and depreciation expense are reasonable. Therefore, Staff recommends approval of the revenue increase requested by Crittenden-Livingston based upon finding that certain pro forma expenses are reasonable, as discussed below. We caution that the documentation problems encountered in this case prevented us from pinpointing a reasonable level of ongoing expenses, but we did obtain enough information to satisfy ourselves that the proposed rate increase is necessary to provide Crittenden-Livingston with the cash flow necessary to meet operating expenses and pay its debt service coverage.

Given the documentation problems experienced in this case, as well as the issues raised by the Kentucky State Police investigation and Crittenden-Livingston's CPA audit, Crittenden-Livingston should be advised that future rate filings should be supported by much greater documentation. This includes not only implementation of stronger internal controls and records retention procedures, but also ensuring that its books and records are maintained in accordance with the Uniform System of Accounts prescribed by the Commission for Class A & B water districts. If needed, Commission Staff is available, upon request, to assist Crittenden-Livingston in this process well in advance of its next rate filing.

Debt Service Coverage – Crittenden-Livingston's application reflected debt service costs of \$581,552 for 2004, which it proposed to increase to \$1,074,019, an adjustment of \$492,467. These debt service costs included financing from the Kentucky Area Development District which was not approved by the Commission. The remaining debt service relates to KIA debt service of \$86,316, prior debt service related to Rural Development financing of \$478,698, and new debt service associated with the Phase IX project payable to Kentucky Rural Water Finance Corporation of \$305,016. Excluding the debt service associated with debt that was not approved by the Commission, and allowing a 1.2 debt service coverage on the latter two debt categories, results in pro forma recommended debt service coverage of \$1,026,773.

Depreciation Expense – Crittenden-Livingston's 2004 depreciation expense was \$369,820 on end-of-year plant of \$16,603,687. Crittenden-Livingston's 2004 depreciation schedule did not include depreciation expense on \$3,606,769 of Construction Work in Progress related to its Phase IX construction project approved by

the Commission in November 2004. In its application, Crittenden-Livingston proposed no pro forma adjustments for depreciation expense related to this project, although it did propose both a revenue adjustment for 385 new applicants and debt service adjustments associated with the project. Assuming a conservative 50-year life for this project, Crittenden-Livingston could have justified a pro forma depreciation adjustment of \$72,135 for this plant.

In addition, Crittenden-Livingston proposed no adjustments to normalize depreciation expense for plant added and disposed of during 2004. Normalizing for plant added, disposed of, or fully depreciated in 2004, results in a normalization adjustment to reduce depreciation expense by \$382, as follows:

| Plant Item- 2004 Additions | Book Cost | Life | Full Yrs. Deprec. | 2004 Deprec. | Adjustment |
|--------------------------------|-----------|------|-------------------|--------------|---------------|
| Pump Myers 75 HP | \$13,860 | 35 | \$396.00 | \$263.99 | |
| Water Mains | \$7,215 | 50 | \$144.30 | \$72.15 | |
| Mains (Cap Wages) | \$5,309 | 50 | \$106.18 | \$53.09 | |
| Services | \$1,900 | 35 | \$54.28 | \$27.14 | |
| Services (Cap Wages) | \$3,360 | 35 | \$96.00 | \$48.00 | |
| Services – A/P | \$1,739 | 35 | \$8.18 | \$4.14 | |
| Meters | \$5,891 | 35 | \$168.32 | \$84.16 | |
| Meters (Cap Wages) | 15,930 | 35 | \$455.14 | \$227.57 | |
| Meters – A/P | 8,387 | 35 | \$239.63 | \$19.97 | |
| Hydrants | 6,321 | 50 | \$126.42 | \$63.21 | |
| Hydrants (Cap Wages) | \$2,421 | 50 | \$48.42 | \$24.21 | |
| Hydrants – A/P | \$3,022 | 50 | \$60.44 | \$5.04 | |
| Vega 6" PVC Drill | \$922 | 5 | \$184.40 | \$92.25 | |
| 2005 Chevy ½ Ton Truck | \$44,806 | 5 | \$8,961.00 | \$0 | |
| Total - Additions | | | \$11,048.71 | \$984.92 | \$10,063.79 |
| Disposals & Fully Depreciated | | | Pro forma | | |
| Tape Drive | \$850 | 5 | 0 | \$141.67 | |
| Compaq Software | \$3,058 | 5 | 0 | \$254.85 | |
| Trencher | \$51,743 | 5 | 0 | \$9,486.22 | |
| Chevy 1 Ton Truck | \$3,073 | 5 | 0 | \$563.41 | |
| Total - Reductions | | | | \$10,446.15 | (\$10,446.15) |
| Total Normalization Adjustment | | | | | (\$382.36) |

The net effect of these adjustments to depreciation is that Crittenden-Livingston could have justified additional depreciation expense of \$71,753, which when added to 2004 depreciation expense of \$369,820 results in pro forma depreciation expense of \$441,573.

Employee-Related Costs – In 2004, Crittenden-Livingston reported Salaries and Wages Expense of \$308,840. In addition, the District paid \$52,393 in retirement contributions to the County Employees Retirement System (“CERS”), and it also paid FICA taxes at 7.65 percent of salaries and wages, which should equal \$23,626 in FICA tax expense. In its application, Crittenden-Livingston proposed no adjustments to Salaries and Wages Expense. However, information obtained during Staff’s field visit indicated all of the District’s employees were granted a five percent wage increase at the beginning of 2005. Inclusion of a five percent increase over 2004 Salaries and Wages Expense would result in an adjustment of \$15,442, or pro forma Salaries and Wages Expense of \$324,282. In addition, pro forma FICA taxes on this amount at a 7.65 percent rate would be \$24,807, an increase of \$1,181. Including the 2004 retirement contributions of \$52,393 would result in total pro forma employee-related expenses of \$401,482.

Purchased Power – Crittenden-Livingston reported Purchased Power Expense of \$69,492 for 2004, and it proposed pro forma Purchased Power Expense of \$75,404, an adjustment of \$5,912. Crittenden-Livingston’s pro forma adjustment assumed this expense would increase with increased water sales of 25,171,364 gallons, at a rate of 0.235 cents per thousand gallons. In Crittenden-Livingston’s last rate case, pro forma Purchased Power Expense of \$64,705 was based on normalized water sales of over 264 million gallons.

Commission Staff received documentation from Crittenden-Livingston's three electricity suppliers verifying amounts paid in 2004. Based upon this documentation and the reasonableness of Crittenden-Livingston's proposed adjustment, Commission Staff recommends inclusion of pro forma Purchased Power Expense of \$75,404.

Chemicals Expense – Crittenden-Livingston reported Chemicals Expense of \$71,880 for 2004, and it proposed pro forma Chemicals Expense of \$77,051, an adjustment of \$5,171. Crittenden-Livingston's pro forma adjustment assumed this expense would increase with increased water sales of 25,171,364 gallons, at a rate of 0.24 cents per thousand gallons.

Commission Staff received documentation from three of Crittenden-Livingston's chemical suppliers verifying \$44,919 in amounts paid in 2004. Using only this amount to figure pro forma Chemicals Expense based upon increased water sales, the chemical cost per thousand gallons would be .1518 cents per thousand, and the pro forma adjustment based on increased sales of 25,171,364 gallons would be \$3,821. Therefore, based upon this documentation and the pro forma adjustment, Commission Staff recommends inclusion of pro forma Chemicals Expense of \$48,740.

Contractual Services Expense – Commission Staff verified Contractual Services Expenses of \$12,514 paid in 2004 for accounting services. For reasons unknown to Commission Staff, Crittenden-Livingston takes a portion of its Employee Wages and Salaries and reclassifies them to Contractual Services Expense, which confuses the issue of how much Crittenden-Livingston actually pays for contract services. For purposes of justifying Crittenden-Livingston's proposed rate increase, Staff

recommends accepting Contractual Services Expense of \$12,514, but notes that actual and reasonable Contractual Services Expense is most likely much higher.

Insurance – General Liability – Staff received information from the Kentucky League of Cities verifying an annual premium of \$32,380 for commercial liability, property and workers' compensation coverage. Therefore, this amount has been included in Crittenden-Livingston's revenue requirement.

Summary

Attachment A of this report shows the test period expense amounts that could be verified by Staff, as well as other pro forma adjustments recommended by Staff. Staff recognizes that Crittenden-Livingston has certain normal expenses such as telephone, purchased water, contractual services, materials and supplies, bad debt, advertising, and other expenses. However, because Staff could not verify the accuracy or reasonableness of those expenses due to documentation problems, and because they were not critical to determining the need for Crittenden-Livingston's proposed rate increase, they were not included as pro forma expenses in Attachment A.

Eddie Beavers is responsible for all revenue adjustments and the calculation of the proposed rates, as discussed in Attachment B of this report. Jack Kaninberg is responsible for the determination of the revenue requirement. Based on Staff's verification of certain pro forma expenses as shown in Attachment A, Staff recommends approval of Crittenden Livingston's proposed revenue increase of \$517,792.

Signatures

Prepared by: Jack Kaninberg
Financial Analyst, Water and Sewer
Revenue Requirements Branch
Division of Financial Analysis

Prepared by: Eddie Beavers
Rate Analyst, Communications, Water,
and Sewer Rate Design Branch
Division of Financial Analysis

Attachment A

Staff Report Case No. 2005-00355

CRITTENDEN-LIVINGSTON'S PRO FORMA, WITH ADJUSTMENTS BY STAFF

| Account | Adjusted 2004 | Proposed Adjustments | |
|---------------------------------|--------------------|-------------------------|--------------------|
| Retail Water Sales | \$1,063,937 | 0 | \$1,063,937 |
| Wholesale Water Sales | \$400,995 | | \$400,995 |
| Forfeited Discounts | \$24,806 | | \$24,806 |
| Misc. Service Revenues | \$23,755 | | \$23,755 |
| Interest Income | \$8,229 | | \$8,229 |
| Tot. Operating Revenues | \$1,521,722 | 0 | \$1,521,722 |
| Employee Salaries | \$308,840 | \$15,442 | \$324,282 |
| Employee Benefits | \$52,393 | 0 | \$52,393 |
| Purchased Water | \$2,509 | (\$2,509) | 0 |
| Purchased Power | \$75,404 | 0 | \$75,404 |
| Chemicals | \$77,051 | (\$28,311) | \$48,740 |
| Materials/Supplies | \$15,327 | (\$15,327) | 0 |
| Contractual Services | \$126,124 | (\$113,610) | \$12,514 |
| Insurance –Gen. Liability | \$53,291 | (\$20,911) | \$32,380 |
| Insurance-Other | \$12,235 | (\$12,235) | 0 |
| Advertising | \$2,143 | (\$2,143) | 0 |
| Bad Debt Expense | \$1,606 | (\$1,606) | 0 |
| Misc. Exp. | \$70,306 | (\$70,306) | 0 |
| Tot. Water Util. Exp. | \$797,229 | (\$251,516) | \$545,713 |
| Depreciation Exp. | \$369,820 | \$71,753 | \$441,573 |
| Amortization Expense | \$5,278 | 0 | \$5,278 |
| Taxes Other Than Income | \$69,217 | (\$44,410) | \$24,807 |
| Util. Operating Expense | \$1,241,544 | (\$224,173) | \$1,017,371 |
| <i>Utility Operating Income</i> | <i>\$280,178</i> | <i>\$224,173</i> | <i>\$504,351</i> |

| | | | |
|---------------------------|------------------|---------------------------------|------------------|
| Operating Expenses | \$1,241,544 | (\$224,173) | \$1,017,371 |
| Principal | \$317,676 | | \$1,026,773 |
| Interest Expense | \$577,340 | | |
| Debt Service Coverage | \$179,003 | \$ | |
| Revenue Requirement | \$2,315,563 | \$ | \$2,044,144 |
| Less: Operating Revenues | \$1,521,722 | 0 | \$1,521,722 |
| Increase Justified | \$793,841 | \$ | \$522,422 |
| Increase Requested | \$517,792 | Increase Recommended | \$517,792 |

Attachment B
Staff Report Case No. 2005-00355
Rate Making Discussion

Field Review: Staff conducted a field review and discussions with Carryn Lee of The Kentucky Rural Water Association. Ms. Lee is responsible for the Cost of Service Study filed in Crittenden-Livingston's application. Ms. Lee provided depreciation allocations based on ten percent of the total depreciation that could be sought by the utility. Staff accepts Ms. Lee's calculations and methodology of the plant and depreciation allocations that were filed in Crittenden-Livingston's application.

Normalized Revenue: The total normalized revenue from water sales as stated in Crittenden-Livingston's application was \$1,925,954. Crittenden-Livingston's 2004 Annual Report stated revenue from water sales of \$1,396,258 was adjusted by Ms. Lee to develop the normalized revenue from rates.

Tariff Submission: Staff discussed some discrepancies with Ms. Lee who assisted Crittenden-Livingston on their tariff as submitted with their application. At issue is the Extension Procedures for Developers and/or New Subdivisions at No. 2. Staff would recommend that the District refund policy remain consistent with all extensions. In the District's section on Water Main Extensions the District stipulates that, "In all extensions the utility shall pay fifty (50) foot per applicant." Staff recommends that the District use this same refund policy for extensions for developers and/or new subdivisions.

Staff's Rate Discussion: Staff concurs with the method used in the Cost of Service Study filed with the application.

MONTHLY RATES

5/8" x 3/4" Meter

| | | | | |
|-------|--------|---------|---------|-------------------|
| First | 1,000 | Gallons | \$16.00 | Minimum Bill |
| Next | 9,000 | Gallons | 9.10 | per 1,000 Gallons |
| Next | 10,000 | Gallons | 7.80 | per 1,000 Gallons |
| Over | 20,000 | Gallons | 6.15 | per 1,000 Gallons |

1" Meter

| | | | | |
|-------|--------|---------|---------|-------------------|
| First | 5,000 | Gallons | \$52.40 | Minimum Bill |
| Next | 5,000 | Gallons | 9.10 | per 1,000 Gallons |
| Next | 10,000 | Gallons | 7.80 | per 1,000 Gallons |
| Over | 20,000 | Gallons | 6.15 | per 1,000 Gallons |

2" Meter

| | | | | |
|-------|--------|---------|----------|-------------------|
| First | 15,000 | Gallons | \$136.90 | Minimum Bill |
| Next | 5,000 | Gallons | 7.80 | per 1,000 Gallons |
| Over | 20,000 | Gallons | 6.15 | per 1,000 Gallons |

Bulk Sales

6.15 per 1,000 Gallons

NONRECURRING CHARGES

| | |
|--|-------------|
| Meter Connection/Tap-on Charge | |
| 5/8 x 3/4 Inch Meter | \$500.00 |
| All Larger Meters | Actual Cost |
| Connection/Turn-on Charge | 25.00 |
| Connection/Turn-on Charge (After Hours) | 35.00 |
| Field Collection Charge | 25.00 |
| Late Payment Penalty | 10% |
| Meter Relocation Charge | Actual Cost |
| Damage to Meter Setting or Lid | Actual Cost |
| (Field Visit plus equipment replaced) | |
| Meter Re-read Charge | 25.00 |
| Meter Re-read Charge (After Hours) | 35.00 |
| Meter Test Charge | 45.00 |
| Reconnection Charge | 45.00 |
| Reconnection Charge (After Hours) | 55.00 |
| Returned Check Charge | 25.00 |
| Service Call/Investigation | 25.00 |
| Service Call/Investigation (After Hours) | 35.00 |