

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF NORTHERN KENTUCKY	)	
WATER DISTRICT FOR (A) AN ADJUSTMENT	)	
OF RATES; (B) A CERTIFICATE OF PUBLIC	)	CASE NO.
CONVENIENCE AND NECESSITY FOR	)	2005-00148
IMPROVEMENTS TO WATER FACILITIES; 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 \$29,000,000 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 \$3,375,319 to \$37,434,519.<sup>1</sup> By this Order, we authorize the requested financing and establish rates that will produce annual revenues from water sales of \$36,293,227, an increase of \$2,299,957 over normalized revenues from water sales of \$33,993,270.

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 78,085 customers in Kenton and Campbell counties, Kentucky and wholesale water service to Bullock Pen Water District,

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

Pendleton County Water District, and the city of Walton, Kentucky.<sup>2</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>3</sup> It last applied for a rate adjustment in 2003.<sup>4</sup>

### PROCEDURE

On April 1, 2005, Northern District notified the Commission of its intent to file an application for an adjustment of rates. On May 27, 2005, Northern District tendered its application. Because of filing deficiencies, the Commission did not accept the application for filing until July 1, 2005. On July 21, 2005, the Commission suspended the rates for 5 months from August 1, 2005 up to and including December 31, 2005 and established this proceeding to investigate the reasonableness of Northern District's proposed rates.

In its original application, Northern District proposed the establishment of a mechanism to permit annual adjustments in an expedited manner and without the level of review generally associated with a general rate adjustment. On February 7, 2006, Northern District amended its application to withdraw its proposal for such mechanism.

The Attorney General of the Commonwealth of Kentucky ("AG") is the only intervenor in this proceeding. Following extensive discovery, the Commission held a public hearing on the proposed rate adjustment on February 28, 2006. The following

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<sup>2</sup> 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, 2004 ("2004 Annual Report") at 27 and 30.

<sup>3</sup> 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 (Ky. PSC August 22, 1996).

<sup>4</sup> Case No. 2003-00224, 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 (Ky. PSC June 14, 2004).

persons testified: Terrell Ross, Chairman and Secretary, Ross, Sinclair and Associates, Inc.; James. C. Sparrow, Partner, Rankin, Rankin, and Company; Roger L. Peterman, Peck, Shaffer & Williams LLP; Ronald C. Lovan, President, Northern District; Richard Harrison, Northern District's Vice President of Engineering/Distribution; Ronald Barrow, Northern District's Vice President of Finance; Peggy L. Howe, Director, Enterprise Management Solutions Division, Black & Veatch; and Mark Lofland, Northern District's Vice President of Account Services and Billing.<sup>5</sup>

### PROPOSED CONSTRUCTION

Northern District identifies approximately \$25,276,500<sup>6</sup> of projects planned for construction in 2005 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>7</sup> Of the projects identified in its application, only the Grand Avenue project requires a Certificate. On January 5, 2006, the Commission granted a Certificate for this project.

### ISSUANCE OF REVENUE BONDS

In its application, Northern District proposed to fund its construction projects through the issuance of \$29,000,000 of 25-year parity revenue bonds<sup>8</sup> having an interest rate of 4.75 percent per annum.<sup>9</sup> Northern District's financial advisor

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<sup>5</sup> The parties stipulated to the entry of the written testimony of Messrs. Sparrow, Peterman, and Lovan into the record. Transcript ("Tr.") at 11 and 108.

<sup>6</sup> Application, Corrected Exhibit O (filed July 1, 2005).

<sup>7</sup> Application at 3.

<sup>8</sup> Application, Exhibit A at 6.

<sup>9</sup> Tr. at 18.

subsequently revised the water district's estimates for the interest rate on the proposed bonds from 4.25 to 4.50 percent per annum.<sup>10</sup>

### TEST PERIOD

Northern District proposes to use the 12-month period ending December 31, 2004 as the test period to determine the reasonableness of its proposed rates. The Commission finds the use of this period reasonable. In using a historic test period, the Commission gives full consideration to appropriate and known and measurable changes.

### INCOME STATEMENT

For the test period, Northern District reports actual operating revenues and expenses of \$32,265,269<sup>11</sup> and \$25,077,528,<sup>12</sup> respectively. Northern District proposes several adjustments to revenues and expenses to reflect current and anticipated operating conditions, resulting in pro forma operating revenues of \$35,932,745<sup>13</sup> and pro forma operating expenses of \$25,704,182.<sup>14</sup> The Commission's review of these proposed adjustments is set forth below.

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<sup>10</sup> Id.

<sup>11</sup> Cost-of-Service Study at 7-8. \$30,873,190 (Operating Revenues – Water Sales) + \$621,870 (Forfeited Discounts) + \$452,661 (Property Rents) + \$258,818 (Turn-on Fees) + 58,730 (Private Fire Protection) = \$32,265,269.

<sup>12</sup> 2004 Annual Report at 11. \$19,429,652 (Operating Expenses) + \$5,128,169 (Depreciation) + \$519,707 (Taxes Other Than Income) = \$25,077,528.

<sup>13</sup> Cost-of-Service Study at 7-8. \$1,873,546 (Revenues Not Subject to Rate Increase) + \$34,059,199 (Test Year Revenue under Existing Rates) = \$35,932,745.

<sup>14</sup> Id., at 3. \$20,375,306 (Operation & Maintenance) + \$5,328,876 (Depreciation) = \$25,704,182.

## Operating Revenues from Water Sales

Northern District reports test-period operating revenues from water sales of \$30,873,190.<sup>15</sup> The reported revenues from water sales are comprised of revenue from retail water sales of \$29,915,559, revenue from bulk sales of \$5,081, and revenue from wholesale water sales of \$778,032.<sup>16</sup>

Northern District proposes to increase its test-period retail water sales by 707,000 centum cubic feet (“CCF”) and revenues from retail water sales by \$1,820,339 to normalize revenues for below normal water usage that resulted from above normal rainfall during the test period.<sup>17</sup> The Commission has previously accepted the practice of weather normalization for establishing a water utility’s rates.<sup>18</sup> While the Commission finds that Northern District’s normalization methodology is generally acceptable, we are concerned with its use of precipitation data from areas outside of Northern District’s service territory. While the Commission will accept the proposed adjustment in this proceeding, we place Northern District on notice that we will closely scrutinize any proposed weather normalization adjustment in future proceedings and that the use of precipitation data from areas outside of its service territory will not be considered and may result in rejection of any proposed weather normalization adjustment. The Commission strongly encourages Northern District to retain a person who is knowledgeable and experienced in weather normalization methodology. Based upon

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<sup>15</sup> Id. at 8.

<sup>16</sup> Id.

<sup>17</sup> Id.

<sup>18</sup> See, e.g., Case No. 2004-00103, Adjustment of the Rates of Kentucky-American Water Company (Ky. PSC Feb. 28, 2005) at 40-41.

our review of the evidence, we find that retail water sales should be increased by 707,000 CCF and retail operating revenues should be increased by \$230,905.

Northern District also proposes to increase test-period revenues from its retail customers by \$296,835 to reflect 900 new connections that it expects to occur in 2005 from extension of services and system growth.<sup>19</sup> Northern District's end-of-period customer level for 2005 is 78,877,<sup>20</sup> an increase of 792 above the test-period level of 78,085. Using the actual increase in customers that occurred in 2005, the Commission calculates an increase in test-period revenues from water sales of \$230,905. Since an adjustment to reflect the actual customer growth is known and measurable, the Commission finds that operating revenues should be increased by \$230,905.

Northern District's current rates became effective for services rendered on and after June 14, 2004. To normalize its operating revenues to reflect a full year of the increased rates, Northern District proposes to increase retail water revenues by \$632,245 and wholesale revenues by \$32,150.<sup>21</sup> The Commission finds that the adjustment to normalize for the rate increase occurring during the test period is reasonable and accepts Northern District's adjustment to increase operating revenues by a total amount of \$664,395.

In April 2004 Northern District acquired the operations of Taylor Mill. Northern District proposes to increase metered retail revenues by \$611,109 and decrease

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<sup>19</sup> Id. In an earlier case, we denied a similar adjustment for expected customer growth as budgetary and not known and measurable. 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 (Ky. PSC April 30, 2003) at 9-10.

<sup>20</sup> Northern District's responses to Staff's Hearing Information Requests made at the Hearing, Witness: Barrow, Item 2.

<sup>21</sup> Cost-of-Service Study at 8.

wholesale revenues by \$206,668 to reflect a full year of retail usage of the customers formerly served by Taylor Mill. The Commission finds that the proposed adjustment meets the rate-making criteria of being known and measurable and accepts Northern District's net adjustment to operating revenues of \$404,441.<sup>22</sup>

The Commission finds that, as a result of these adjustments, Northern District's normalized test-year revenue from water sales is \$33,993,270.<sup>23</sup>

### Surcharge Revenues

In its application, Northern District proposed to increase its test-period operating revenues by \$481,467 to reflect the sub-district surcharge revenues.<sup>24</sup> Northern District subsequently provided the current number of customers in each subdistrict as of December 31, 2005 and the revised surcharge amount based upon this customer level.<sup>25</sup> Finding that any adjustment to test-period operating revenues should be based upon the most recent information, the Commission denies Northern District's proposed adjustment and increases operating revenues by \$552,948.<sup>26</sup>

<sup>22</sup> \$611,109 (Operating Revenues – Retail) - \$206,668 (Wholesale) = \$404,441.

<sup>23</sup> \$33,210,157 (Retail Water Sales) + \$778,032 (Wholesale) + \$5,081 (Bulk) = \$33,993,270.

<sup>24</sup> Cost-of-Service Study at 7.

<sup>25</sup> Northern District's responses to Staff's Hearing Information Requests, Witness: Harrison, Item 1.

<sup>26</sup>

<u>Description</u>	<u>Customer Level</u>	<u>2006 Surcharge</u>	<u>Annual Collections</u>
Sub-District A	509	\$ 9.84	\$ 60,108
Sub-District B	269	\$19.46	62,820
Sub-District C	902	\$20.33	220,056
Sub-District D	132	\$30.00	47,520
Sub-District E	166	\$30.00	59,760
Sub-District K	6	\$30.00	2,160
Sub-District R	233	\$18.89	52,812
Sub-District RF	28	\$25.47	8,556
Sub-District RL	87	\$37.50	+ 39,156
Total			<u>\$ 552,948</u>

Annual collections are based on rounded monthly amounts.

## Salaries and Wages – Employees

Northern District proposes to increase test-period operating expenses by \$16,593<sup>27</sup> to reflect employee wage increases awarded in 2005. This adjustment is based upon end-of-period employee level, actual test-period overtime hours worked, and new wage rates and is in accordance with the methodology that the Commission applied in Northern District's last rate case proceeding.<sup>28</sup> Northern District calculated a pro forma salaries and wages expense of \$7,413,166.<sup>29</sup> Northern District included in its calculation of pro forma expense level the annual salary of \$27,200 associated with an administrative assistant position that was vacant when Northern District submitted its application and remained vacant at the time of the hearing in this proceeding. Because it is uncertain when this position will be filled, any adjustment to reflect this position cannot be considered known and measurable and should be excluded from pro forma salaries and wages expense – employees.

Using the Northern District's employee schedule, removing the Commissioner fees, eliminating the Administrative Assistant salary, and deducting the capitalized labor at a rate of 2.55 percent, the Commission calculates a pro forma level of salaries and

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<sup>27</sup> Northern District's Responses to Commission Staff's First Information Request, Item 1. \$43,239 (Salaries/Wages FICA) - \$26,646 (FICA) = \$16,593.

<sup>28</sup> Case No. 2003-00224, 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 (Ky. PSC June 14, 2004) at 8-10.

<sup>29</sup> Northern District's Responses to Commission Staff's First Information Request, Item 1. \$7,449,166 (Total Less Salaries & Wages Capitalized Labor) - \$36,000 (Salaries & Wages – Commissioners) = \$7,413,166.



wages, and payroll tax expense of \$7,387,894.<sup>30</sup> We find that Northern District's adjustment should be denied and wages and salaries - employee expense should be decreased by \$8,992.

Employee Pensions and Benefits

Northern District reports test-period employee pensions and benefits expense of \$2,040,252, which includes employee insurance<sup>31</sup> expense of \$1,298,474, pension expense of \$583,796, and education/recreation and miscellaneous expense of \$157,982.<sup>32</sup> Northern District proposes to increase employee insurance expense by \$176,081, a 13.6 percent increase over its test-period level.<sup>33</sup> Using an employee schedule, which lists each benefit premium by employee, Northern District calculates its pro forma level of employee insurance expense of \$1,124,815.<sup>34</sup>

In Case No. 2003-00224,<sup>35</sup> the Commission refused to permit the recovery of the costs associated with health insurance, life insurance, and dental insurance coverage provided to members of Northern District's Board of Commissioners that it generally provided only to full-time employees. The Commission found that, since members of

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<sup>30</sup>

<u>Description</u>	<u>Salaries &amp; Wages</u>
Employee Schedule Totals	\$ 7,644,094
Less: Authorized but unfilled Positions	27,200
Less: Commissioner Fees	36,000
Less: Capitalized (2.7%)	<u>- 193,313</u>
Totals	<u>\$ 7,387,581</u>

<sup>31</sup> Employee insurance includes health, life, disability, and dental insurance.

<sup>32</sup> Northern District's Responses to Commission Staff's First Information Request, Item 1.

<sup>33</sup> Id.

<sup>34</sup> Id.

<sup>35</sup> Supra, note 28 at 11-12.

the Board of Commissioners attend only one board meeting per month and are not required to work 40-hour work weeks, they were part-time employees. As Northern District did not provide its other part-time employees with comparable benefits, the Commission found North District's practice of providing benefits to its commissioners is contrary to law and eliminated the costs associated with those benefits from pro forma operations.

Since that proceeding, Northern District has modified its policy to provide benefits to part-time employees who work more than 20 hours per week. Based upon our review of the record, we are of the opinion that Northern District's practice still is contrary to law. As its commissioners meet only once a month and do not appear to work a total of 80 hours per month, Northern District is improperly providing a benefit to its commissioners that it is not providing to other comparable employees.<sup>36</sup> For that reason, the Commission finds the expenses associated with these benefits should be disallowed for rate-making purposes. Such distinctions between board officials and other district employees are contrary to law.

In Case No. 2003-00224 and in the current proceeding, Northern District adjusted its salaries and wages – employee expense to remove the capitalized labor. To match Northern District's labor adjustment, the Commission reduced pensions and benefits to remove the portion that is considered labor overhead and that should have been capitalized as a cost of the construction. Because Northern District does not capitalize labor or labor overhead costs that are associated with construction projects, it claims that reducing the expenses in a rate case constitutes a penalty.<sup>37</sup>

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<sup>36</sup> See OAG 94-15 (Mar. 4, 1994).

<sup>37</sup> Tr. at 106.

The Uniform System of Accounts for Class A/B Water Districts and Associations

("USoA") states:

The cost of construction properly includible in the utility plant accounts shall include, where applicable, the direct and overhead costs as listed and defined hereunder: ... "Labor" includes the pay and expense of employees of the utility engaged on construction work, an related workers' compensation insurance, payroll taxes and similar items of expense<sup>38</sup>

Northern District has failed to show why the USoA should not be applicable to its operations or why the application of the USoA would produce an unfair or unreasonable result. Accordingly, the Commission finds that pensions and benefits should be reduced to eliminate the overhead labor costs that should be capitalized.

Using the insurance premiums listed on the employee schedule, eliminating the commissioner's insurance benefits, removing the benefits provided to the vacant administrative assistant position, and using the employer retirement contribution rate of 10.38 percent, the Commission calculates a pro forma level of employee pensions and benefits expense of \$2,306,488.<sup>39</sup> Accordingly, Northern District's proposed adjustment should be denied and employee pensions and benefits expense should be increased by \$266,237 to its pro forma level of \$2,306,488.

<sup>38</sup> Uniform System of Accounts for Class A/B Water Districts and Associations at 20 (2002) (found at <http://psc.ky.gov/agencies/psc/forms/usoa/0700ab02.pdf>).

<sup>39</sup>

<u>Descriptions</u>	<u>Test-Period</u>	<u>Pro Forma</u>	<u>Inc/(Dec)</u>
Insurance – health, life, disability & dental	\$ 1,298,474	\$ 1,387,034	\$ 88,560
Pension Contribution	583,796	761,472	177,676
Education/Recreation and Miscellaneous	+ 157,982	+ 157,982	+ 0
Total	<u>\$ 2,040,251</u>	<u>\$ 2,306,488</u>	<u>\$ 266,237</u>

## Contractual Services – Engineering

Northern District reports a test-period level of contractual services – engineering expense of \$113,674. Included in this amount are engineering fees of \$19,800<sup>40</sup> that were incurred to prepare the Taylor Mill addendum to North District’s hydraulic master plan. Because, the cost of the addendum is non-recurring and will provide a benefit to more than one period, the Commission is of the opinion that these engineering fees should be removed from operating expenses and amortized over 5 years. The Commission finds that contractual services should be reduced by \$19,800 and that amortization expense should be increased by \$3,960.

The Commission identified several engineering fees<sup>41</sup> that were incurred for capital projects. 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 an additional \$27,755.

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<sup>40</sup> Black & Veatch – Taylor Mill addendum Hydraulic Master Plan	\$ 6,895
Black & Veatch – Taylor Mill addendum Hydraulic Master Plan	+ 12,905
Total Non-recurring Eng. Fees	<u>\$ 19,800</u>

<sup>41</sup>

<u>Vendor</u>	<u>Description</u>	<u>Amount</u>
Thelen & Assc.	Design Locust Pike Water Main Extension	\$ 6,983
Thelen & Assc.	Design Licking Pike Water Main Extension	991
Viox & Viox Inc.	Update cost est. - Liberman Rd, Fowler Creek Mains	1,473
Viox & Viox Inc.	Update survey of Taylor Mill Tank Site	2,236
Erpenbeck Consulting	Preliminary Design Water Main Extension Cody Road	1,114
Viox & Viox Inc.	Update cost est. - Liberman Rd, Fowler Creek Mains	1,721
Viox & Viox Inc.	Update cost estimates - Old State road	5,778
Erpenbeck Consulting	Preliminary Design Water Main Extension Cody Road	2,659
Thelen & Assc.	Evaluation of remaining life of Aqua Drive Site.	+ 4,800
Total Capital Engineering Fees		<u>\$ 27,755</u>

## Contractual Services – Legal

Northern District reports a test-period level of contractual services – legal expense of \$115,926. Northern District identified legal fees of \$11,189<sup>42</sup> as being associated with either prior rate cases or the pending cross-connection tariff case.<sup>43</sup> Northern District asserts that the descriptions of the legal fees were taken from its accounting system that combined all the activities for a particular bill and that the legal fees that were associated with the rate case were properly amortized.<sup>44</sup> If legal fees were for services or activities other than those listed, the description of those other services would be included in the description. Furthermore, in the responses filed after the hearing, Northern District should have identified any other activity that was billed for on that invoice and should have shown the fee for each activity. For this reason, the Commission has reduced legal fees by \$11,189 to prevent the double recovery of these legal fees as an operating expense and through the fees' amortization.

Included in the disallowed portion are legal fees of \$4,424<sup>45</sup> that Northern Kentucky incurred in litigation against Wessels Construction Company. The Commission finds that the cost of this litigation is a non-recurring expense and, therefore, is more appropriately recovered through amortization over a 3-year period.

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<sup>42</sup> John Hughes, Attorney – Rate Case	\$ 6,988
John Hughes, Attorney – Rate Case & Cross-connections	2,247
John Hughes, Attorney – Rate Case & Cross-connections	+ 1,954
Total Legal Fees – Prior Proceeding	<u>\$ 11,189</u>

<sup>43</sup> Case No. 2004-00309, The Tariff Filing of Northern Kentucky Water District to Amend Its Cross-Connection Control Policy (Ky. PSC filed Aug. 5, 2004).

<sup>44</sup> Northern District's Responses to Staff's Hearing Information Requests, Witness: Barrow, Item 4.

<sup>45</sup> Frost Brown Todd LLC – NKWD vs. Wessels Construction Co.	\$ 1,557
Frost Brown Todd LLC – NKWD vs. Wessels Construction Co.	1,355
Frost Brown Todd LLC – NKWD vs. Wessels Construction Co.	+ 1,512
Total Non-recurring Eng. Fees	<u>\$ 4,424</u>

The Commission finds that contractual services should be reduced by \$4,424 and that amortization expense should be increased by \$1,475.<sup>46</sup>

The following legal fees were for capital projects. Therefore, the Commission finds that legal fees should be reduced by \$19,193 to reflect the removal of certain legal fees for capital projects. These fees should instead be included as overhead in the appropriate capital project.<sup>47</sup>

Contractual Services – Other

Northern District reports a test-period level of contractual services – other expense of \$3,736,186, which includes mainline cleaning and lining fees of \$793,155.<sup>48</sup> Northern District based its decision to expense these costs upon a joint review of these fees with its independent auditor in which it was mutually determined that the services

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<sup>46</sup> \$4,424 (Non-recurring Legal Fees) ÷ 3 Years = \$1,475.

<sup>47</sup>

<u>Vendor</u>	<u>Description</u>	<u>Amount</u>
Hemmer, Spoor Pangburn	Purchase Cincinnati Steel Treating Co.	\$ 5,274
Hemmer, Spoor Pangburn	Purchase Taylor Mill Water System	1,878
Hemmer, Spoor Pangburn	Purchase Taylor Mill Water System	1,046
Hemmer, Spoor Pangburn	Purchase Cincinnati Steel Treating Co.	2,211
Hemmer, Spoor Pangburn	Purchase Cincinnati Steel Treating Co.	2,335
Hemmer, Spoor Pangburn	Purchase Cincinnati Steel Treating Co.	3,499
Hemmer, Spoor Pangburn	Purchase Cincinnati Steel Treating Co.	1,755
Hemmer, Spoor Pangburn	Purchase Cincinnati Steel Treating Co.	+ 1,195
Total Capital Legal Fees		<u>\$ 19,193</u>

<sup>48</sup> Northern District’s Response to Commission Staff’s Third Information Request, Item 33(e)(4).

associated with these expenses did not extend the life of the mains, but only allowed the mains to be used for their estimated useful life.<sup>49</sup>

By performing the mainline cleaning and lining, Northern District is avoiding the cost to replace its mains before they have been fully depreciated. The mainline cleaning and lining costs benefit future ratepayers by allowing the mains to reach their estimated useful lives and avoiding the premature replacement of these mains. For this reason, the mainline cleaning and lining costs should be capitalized rather than expensed. Accordingly, the Commission reduces contractual services – other expense by \$793,155 and increases depreciation expense by \$28,056.<sup>50</sup> Depreciation expense reflects depreciating over 50 years the costs that Northern District incurred to clean and reline its mains since its last rate case proceeding or the costs reported in the calendar years 2003 and 2004.<sup>51</sup>

Rate Case Amortization

Northern District proposes to increase test-period rate case amortization expense of \$165,808 by \$41,384 to reflect amortizing the cost of Case No. 2002-00105 and Case No. 2003-00224 over a 3-year period. Northern District states that the cost of Case No. 2002-00105 will be fully amortized by July 2006.<sup>52</sup> Given that the amortization of Case No. 2002-00105 will not be an on-going expense after July 2006, the Commission is of the opinion that the amortization should be excluded from pro forma

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<sup>49</sup> Id., Item 33(e)(3).

<sup>50</sup> 2003	\$609,625 ÷ 50 Years =	\$	12,193
2004	\$793,155 ÷ 50 Years =	+	15,863
Total		\$	<u>28,056</u>

<sup>51</sup> Northern District's Response to the Staff's Third Information Request, Item 33(e)(4).

<sup>52</sup> Northern District's Responses to Staff's Hearing Information Requests, Witness: Barrow, Item 3.

operations. The Commission further finds that Northern District's adjustment should be denied and that rate case amortization should be decreased by \$22,066.<sup>53</sup>

Depreciation

Northern District proposes to increase its test-period depreciation expense of \$5,128,169 by \$200,707 to a pro forma level of \$5,328,876 to reflect depreciation of the capital projects included in Exhibit O of the Application. The Commission finds that the proposed adjustment is reasonable and should be accepted.

Payroll Taxes

Northern District proposes to increase its test-period FICA tax expense of \$519,707 by \$26,646 to reflect the impact of the 2005 wage increases on payroll taxes.<sup>54</sup> Based on the pro forma salaries and wages found reasonable herein, and capitalizing 2.55 percent, the Commission calculates a pro forma FICA expense of \$533,309. The Commission finds that Northern District's proposed adjustment should be denied and that taxes other than income taxes should be increased by \$13,602.

Boone/Florence Reserve

Northern District proposes to increase non-operating income by \$443,685 to reflect the amortization over 10 years of the reserve fund payment and termination payment received from Florence and Boone District. The proposed adjustment

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<sup>53</sup>

Total Rate Case Expense - Current Proceeding	\$	244,999
Divided by: amortization Period	÷	3
Rate Case Amortization - CN 2005-00148	\$	81,666
Rate Case Amortization - CN 2003-00224	+	62,076
Pro Forma Rate Case Amortization	\$	143,742
Less: Test-Period Rate Case Amortization	-	165,808
Pro Forma Adjustment	\$	(22,066)

<sup>54</sup> Northern District's Response to Commission Staff's First Information Request, Item 1.



conforms to prior Commission decisions. 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>Actual Operations</u>	<u>Pro Forma Adjustments</u>	<u>Pro Forma Operations</u>
Operating Revenues:			
Sales of Water	\$ 30,873,190	\$ 3,120,080	\$ 33,993,270
Other Operating Revenues	1,392,078	552,948	1,945,026
Total Operating Revenues	<u>\$ 32,265,268</u>	<u>\$ 3,673,028</u>	<u>\$ 35,938,296</u>
Operating Expenses:			
Operation & Maintenance	\$ 19,429,652	\$ (640,337)	\$ 18,789,315
Depreciation	5,128,169	230,069	5,358,238
Amortization	0	5,435	5,435
Taxes Other Than Income	519,707	13,602	533,309
Utility Operating Expenses	<u>\$ 25,077,528</u>	<u>\$ (391,231)</u>	<u>\$ 24,686,297</u>
Net Utility Operating Income	\$ 7,187,740	\$ 4,064,259	\$ 11,251,999
Other Income & Deductions	952,600	443,685	1,396,285
Income Available for Debt Service	<u>\$ 8,140,340</u>	<u>\$ 4,507,944</u>	<u>\$ 12,648,284</u>

REVENUE REQUIREMENT DETERMINATION

Debt Service

Northern District's proposed debt service for bonded debt of \$12,291,807<sup>55</sup> reflects a 5-year average principal and interest payment for all debt outstanding at the time the application was prepared, as well as the proposed \$29,000,000 bond issuance. The Commission calculates a debt service for bonded debt of \$12,248,534 using a 3-year average principal and interest payment and the amortization schedule for the proposed bonds that reflects the market conditions as of the hearing date.

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<sup>55</sup> Cost-of-Service Study at 5.

## Revenue Requirement

Based upon the Commission's findings and determinations herein, Northern District requires an increase in revenues of \$2,299,957, determined as follows:

3 Year Average Debt Service	\$ 12,248,534
Multiplied by: Debt Service Coverage Coverage	X <u>0.2</u>
	\$ 2,449,707
Add: 3 Year Average Debt Service	12,248,534
Annual Debt Service – Taylor Mill Note	250,000
Pro Forma Utility Operating Expenses	+ <u>24,686,297</u>
Total Revenue Requirement	\$ 39,634,538
Less: Interest Income	791,405
Miscellaneous Income	161,195
Boone & Florence – Reserve	- <u>443,685</u>
Revenue Requirement from Operations	\$ 38,238,253
Less: Other Operating Revenues	- <u>1,945,026</u>
Revenue Requirement from Water Sales	\$ 36,293,270
Less: Pro Forma Revenue from Water Sales	- <u>33,993,270</u>
Required Increase	\$ <u><u>2,299,957</u></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. The Commission finds that the Cost-of-Service Study is reasonable and should be accepted.

## RATE DESIGN

Northern District's 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 Commission accepts Northern District's rate design, but denies the proposed rates because they produce revenue greater than that found reasonable herein.

### PROPOSED TARIFF REVISIONS

Northern District has requested substantial revisions to its existing rate schedules and tariff sheets. Having reviewed these revisions, the Commission finds that they should be approved subject to the specific provisions discussed below.

#### General Provisions

The Commission finds three areas of concern in Sheets No. 4 and No. 5, Section I - General Provisions, of Northern District's proposed tariff. We find not that these provisions are incorrectly numbered. Northern District should correct the numbering on Sheet No. 4 of its proposed tariff to ensure consecutive numbering of the provisions.

At Sheet 5, Item 13, Northern District seeks to impose upon a customer who unlawfully uses water the cost of the unlawful water usage. Northern District proposes to base this cost on estimated use, but has failed to provide the methodology that will be used to derive the estimate. The Commission finds that Northern District should revise this provision to include a detailed description of the methodology which it will use to estimate any unlawful usage.

At Sheet No. 5, Item 14, Northern District proposes, *inter alia*, to assess a fine or penalty for any person who continues to take water service after his meter has been unlawfully removed. Northern District agreed to remove the reference to "any fine that may be imposed" from the proposed tariff.<sup>56</sup> The Commission finds that the language in question should be stricken from the proposed tariff.

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<sup>56</sup> Northern District's Response to Commission Staff's Second Information Request, Item 49.

### Service Charge

At Sheet No. 7, Section IV of its proposed tariff, Northern District proposes to assess a service charge of \$25. It asserts that this charge replaces the Reconnection Charge found in its present rate schedule. At hearing Northern District indicated that this charge would be assessed in instances other than the reconnection of service.<sup>57</sup> While the Commission finds that a charge of \$25 is appropriate to recover the costs associated with service reconnection, we are concerned that the tariff fails to adequately identify and place customers on notice of all instances when the proposed charge may be assessed. Accordingly, we find that, if Northern District wishes to assess this fee for non-reconnection services, it should clearly describe in its tariff the conditions under which the charge will be assessed. When filing a revised tariff to comply with the terms of this Order, Northern District should further elaborate on the conditions under which the proposed service fee will be assessed. We place Northern District on notice that its failure to provide an adequate description of these conditions will result in the fee being limited to reconnections only.

### Leak Adjustment

At Sheet 10, Section IX – Adjustment of Water Bills, Northern District proposes to revise its leak adjustment policy. The Commission finds that the proposed revisions are confusing and require revision. In its current form, the proposed tariff requires a customer to submit a written request for an adjustment and to state “the reason for the elevated consumption and why the origin was not found.” In response to discovery requests, Northern District more clearly defined the information that a customer seeking

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<sup>57</sup> Tr. at 99 – 101.

a leak adjustment should provide.<sup>58</sup> We find that, when filing a revised tariff to comply with the terms of this Order, Northern District should revise its proposed tariff to include this information.

The proposed tariff further provides that a customer is eligible for the leak adjustment only if his or her consumption is in excess of 200 percent of average consumption. It provides for exceptions on “an individual case basis” but provides no guidance on when such exceptions would be warranted. The Commission finds that such unlimited discretion has the potential to result in unreasonable discrimination among similarly situated customers and that the exception provision should therefore be stricken from the proposed tariff.

#### Meter Location

At Sheet 11, Section X – Meter Location and Requirements, of the proposed tariff, Northern District proposes to permit the waiver of the cost of relocating multiple meter settings under certain conditions. As the proposed waiver of a relocation fee is discretionary and not mandatory, the Commission is concerned about the potential for unreasonable discrimination among similarly situated customers. Northern District has stated that it does not object to revising the proposed tariff to make the waiver mandatory.<sup>59</sup> The Commission finds that, with that revision, the Item 1 of the proposed tariff section should be approved.

Northern District further proposes to revise Item 3 of Section X to address meters located inside of buildings. By this revision, Northern District appears to disclaim any responsibility for any piping that connects its outside lines to the meter within the

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<sup>58</sup> Northern District’s Response to Commission Staff’s Second Information Request, Item 53.

<sup>59</sup> Northern District’s Response to Commission Staff’s Second Information Request, Item 55.

building. In support of this provision, Northern District stated that it “should not be held responsible for piping between the customer’s point of service and the inside meter coupling because . . . [it] cannot control the type of piping that the customer uses.”<sup>60</sup> This position is contrary to Administrative Regulation 807 KAR 5:066, Section 12(1)(a), which places upon the water utility responsibility for all facilities to the point of delivery at the meter. Accordingly, we find that this position is unlawful and unreasonable and should be stricken from the proposed tariff.

#### Meter Investigation Charge

Northern District proposes to establish a meter investigation charge. It has failed to provide substantial evidence regarding the nature and need for this charge. In the absence of such evidence, the Commission finds that the charge should be denied. We further advise Northern District that it may apply for the establishment of this charge pursuant to the provisions of Administrative Regulation 807 KAR 5:006, Section 8. Such application should include the amount of the charge, a description of how the charge was determined, and a detailed breakdown of the charge’s components.

#### Private Fire Protection Service

Northern District proposes to revise its existing tariff to address private fire protection service. More specifically, it proposes to require all private fire protection service customers, current and future, to install at their own expense a by-pass meter to detect water usage for non-fire protection purposes on dedicated water lines. Northern District currently requires each customer requesting such service to enter a special contract to install such devices. Northern District argues that such requirement is necessary to prevent customers from unlawfully withdrawing water from its system for

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<sup>60</sup> Northern District’s Response to Staff’s Second Information Request, Item 56.

non-fire protection purposes and requiring other customers to absorb the cost of this usage through higher rates.

While we empathize with Northern District and agree that utilities should take appropriate measures to reduce or eliminate unlawful withdrawals from their systems, Northern District's proposal conflicts with Administrative Regulation 807 KAR 5:090, Section 8, which prohibits the use of metering equipment on services for fire sprinkler systems unless good cause is shown. It further conflicts with our holding in Administrative Case No. 385 in which we found that the "use of metering equipment for fire protection services is generally not cost effective and should not be required absent compelling circumstances."<sup>61</sup> We further stated that the use of metering equipment should only be required when alternative methods to prevent unlawful usage prove unsuccessful or impractical.<sup>62</sup>

In the present case, Northern District has failed to demonstrate the need for metering equipment on all fire protection services. It stated that 153 of 443 accounts in 2005 failed to report usage. It could not provide the amount of the water loss to these non-reporting incidents or determine a level of unlawful or unauthorized usage for 2005. The existing record does not contain sufficient evidence to permit us to conclude that a systematic problem exists. Accordingly, the Commission finds that Northern District's proposed requirement for the installation of by-pass meters on all fire protection services should be denied.

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<sup>61</sup> Administrative Case No. 385, Investigation Into Fees for Fire Protection (Ky. PSC Dec. 6, 2001) at 16.

<sup>62</sup> Id. at 17.

Our action, however, should not be construed as a general prohibition against the use of metering equipment. We acknowledge that the need for the installation of such equipment on specific customers may exist. It is the utility's duty to demonstrate that good cause exists for the installation of such equipment as to that customer. Moreover, we recognize that where a water utility is experiencing systemic unreported usage by its fire protection customers on a large scale, the use of metering equipment on some or all classes of fire protection customers may be warranted. The utility must demonstrate that a systemic problem of sufficient magnitude exists and is attributable to fire protection service. Northern District has not demonstrated the existence of such a problem in this case. When it has obtained sufficient evidence of such a problem, it should reapply to the Commission for the imposition of by-pass meter requirement.

#### Cross-Connection Control Policy

Northern District's proposed tariff contains the Cross-Connection Control Policy that is currently under investigation in another Commission proceeding. By our Order today, we deny our approval to the policy. Our action should not be considered as final action on this policy. It is intended only to defer all issues related to this policy to Case No. 2004-00309. We anticipate issuing a ruling in that proceeding shortly.

#### SUMMARY

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

1. Northern District proposes to fund \$25,276,500 of construction projects, as set forth in its application, with the proceeds of the issuance of \$29,000,000 of 25-year parity revenue bonds with an estimated effective interest rate from 4.25 to 4.50 percent per annum.



2. The proposed bond issuance is for a lawful object 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 and is reasonably necessary and appropriate for such purpose.

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

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

5. Except for those provisions noted in Findings Paragraphs 6 through 15, Northern District's proposed tariff should be approved for service rendered on and after the date of this Order.

6. Northern District should correct the numbering on Sheet No. 4 of its proposed tariff to ensure consecutive numbering of the provisions set forth in Section I.

7. The proposed Sheet No. 5, Section I – General Provisions, Item 13 should be approved, but Northern District should revise this provision to include a detailed description of the methodology which Northern District will use to estimate any unlawful usage.

8. The phrase “any fine that may be imposed” should be stricken from the proposed Sheet No. 5, Section I – General Provisions, Item 14.

9. Northern District should revise its proposed tariff to include a detailed explanation of the “Service Charge” set forth in Sheet No. 7, Section IV – Miscellaneous Service Rates. This explanation should clearly describe under what conditions the charge will be assessed.

10. Northern District should revise Sheet No. 10, Section IX - Type 2 of its proposed tariff to include the conditions that Northern District identified in its response to Commission Staff's Second Information Request, Item 53.

11. The phrase "Exceptions may be granted, however, on an individual case basis" should be stricken from the proposed Sheet No. 10, Section IX - Type 2.

12. Northern District should revise Sheet 11, Section X, Item No. 1 of the proposed tariff to read that "Northern District will waive the fee for all eligible customers."

13. Sheet 11, Section X, Item No. 3 should be stricken from the proposed tariff.

14. The third and fifth paragraphs of Section XXII of the proposed tariff, which deal with the installation of a by-pass meter on private fire protection services and the imposition of a Meter Investigation Charge, respectively, should be denied.

15. Section XXIII of the proposed tariff should be denied. All issues related to Northern District's Cross-Connection Control Policy should be deferred to Case No. 2004-00309.

IT IS THEREFORE ORDERED that:

1. Northern District is authorized to issue approximately \$29,000,000 in parity revenue bonds.

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

3. Northern District's proposed rates are denied.

4. The rates set forth in Appendix A 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.

5. Except for those provisions noted in Ordering Paragraphs 6 through 15, Northern District's proposed tariff is approved for service rendered on and after the date of this Order.

6. Northern District shall correct the number on Sheet No. 4 of its proposed tariff to ensure consecutive numbering of the provisions set forth in Section I.

7. The proposed Sheet No. 5, Section I – General Provisions, Item 13 is approved, but Northern District shall revise this provision to include a detailed description of the methodology it will use to estimate any unlawful usage.

8. The phrase “any fine that may be imposed” is stricken from the proposed r Sheet No. 5, Section I – General Provisions, Item 14.

9. In the revised tariff that it files in accordance with this Order, Northern District shall include a detailed explanation of the “Service Charge” set forth in Sheet No. 7, Section IV – Miscellaneous Service Rates. This explanation shall clearly describe under what conditions the charge will be assessed.

10. Northern District shall revise Sheet No. 10, Section IX - Type 2 of its proposed tariff to include the conditions that Northern District identified in its response to Commission Staff's Second Information Request, Item 53.

11. Northern District shall revise Sheet 11, Section X, Item No. 1 of the proposed tariff to read that “Northern District will waive the fee for all eligible customers.”

12. Sheet 11, Section X, Item No. 3 of the proposed tariff is stricken.

13. The third and fifth paragraphs of Section XXII of the proposed tariff, which deal with the installation of a by-pass meter on private fire protection services and the imposition of a Meter Investigation Charge, respectively, are denied and shall not be included in the revised tariff filed with the Commission in accordance with this Order.

14. The provisions in Sheets 25 through 27, Section XXIII of the proposed tariff are denied. All issues related to Northern District's Cross-Connection Control Policy are deferred to Case No. 2004-00309.

15. 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 28<sup>th</sup> day of April, 2006.

By the Commission

ATTEST:



Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 2005-00148 DATED APRIL 28, 2006

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"	\$10.63	\$16.09
3/4"	\$10.99	\$16.95
1"	\$12.00	\$19.49
1 1/2"	\$13.51	\$22.96
2"	\$17.07	\$32.28
3"	\$41.22	\$100.44
4"	\$51.63	\$126.09
6"	\$76.45	\$186.08
8"	\$103.24	\$254.22
10"	\$137.30	\$331.96

	<u>Commodity Charges</u>		<u>Rates</u>
	<u>Monthly Block</u>	<u>Quarterly Block</u>	
	ccf	ccf	
First	15	45	\$2.81 per ccf
Next	1,635	4,905	\$2.43 per ccf
Over	1,650	4,950	\$2.16 per ccf
Wholesale			\$1.89 per ccf