

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF WESTERN MASON COUNTY)	
WATER DISTRICT FOR A RATE ADJUSTMENT)	CASE NO.
PURSUANT TO THE ALTERNATIVE RATE FILING)	2006-00015
PROCEDURE FOR SMALL UTILITIES)	

ORDER

On February 8, 2006, Western Mason County Water District ("Western Mason") filed its application for Commission approval of its proposed water rates. Commission Staff, having performed a limited financial review of Western Mason'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 attached 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 24th day of March, 2006.

By the Commission

ATTEST:


Executive Director

STAFF REPORT
ON
WESTERN MASON COUNTY WATER DISTRICT
CASE NO. 2006-00015

Pursuant to a request by Western Mason County Water District (“Western Mason”) for assistance with the preparation of a rate application for its water operations, Commission Staff (“Staff”) performed a limited financial review of Western Mason’s test year operations for the calendar year ending December 31, 2004. 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.

Upon completion of the review, Staff assisted Western Mason in the development and preparation of a rate application. The application included an adjusted pro forma operating income statement wherein adjustments were made to test year operating revenues and expenses that were known and measurable and deemed to be reasonable, as shown in Attachment B to this report. The rates proposed by Western Mason were based on the pro forma income statement as shown in the application. The application also includes the calculation of Western Mason’s revenue requirement using a 1.2 debt service coverage, which is frequently used by the Commission to determine revenue requirements for small water utilities. To generate the revenue requirement of \$329,399, Western Mason is proposing to increase its annual revenue from water rates by \$40,349, an increase of 13.96% over normalized revenue including interest income of \$289,050.

Staff's proposed rates were calculated using the principles and guidelines established in the American Water Works Association M-1 manual. Western Mason's increased revenue requirement is partially due to an increase in depreciation expense which has occurred since their most recent filing for a rate increase with the Commission in Case No. 2003-00052.

Western Mason's expenses have been allocated into three separate cost components: commodity costs, demand costs, and customer costs. Commodity costs are those costs that tend to vary with the quantity of water produced, including the costs of chemicals, a large part of power costs, and other elements that follow, or change almost directly with, the amount of water produced. Demand costs are costs associated with providing facilities to meet demands placed on the system by customers. Customer costs are costs directly associated with serving customers, irrespective of the amount of water use.

Depreciation expense is allocated to the cost components based on percentages derived from the utility's accumulated depreciation. The majority of depreciation expense is allocated to the demand costs of the water system in the cost of service study. The resulting effect is a larger increase to those customers using a larger volume of water compared to those customers with a lower consumption of water.

On February 8, 2006, Western Mason filed its rate application to the Commission for consideration. Staff is hereby adopting the contents of Western Mason's application as its recommendation in this report as if fully set out herein. Jason Green is responsible for all revenue adjustments and the calculation of the proposed rates. Jack Kaninberg is responsible for the determination of the revenue requirement. Based on

the information included in Western Mason's application, Staff is of the opinion that the rates as shown in Attachment A of this report are reasonable and should be approved by this Commission.

Signatures

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

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

ATTACHMENT A
STAFF REPORT CASE NO. 2006-00015
STAFF'S RECOMMENDED RATES

Monthly Water Rates

First	2,000 gallons	\$14.72 Minimum Bill
Next	8,000 gallons	3.81 per 1,000 gallons
Over	10,000 gallons	2.65 per 1,000 gallons
Bulk Sales		\$2.76 per 1,000 gallons

Western Mason WD Attachment B	2004	Adjustment	Ref.	Proforma Adjusted
Water Sales	\$284,145	(\$4,554)	(A)	\$279,591
Other Water Rev.	9,426			\$9,426
Total Revenue	\$293,571	(\$4,554)		\$289,017
Employee Salaries	\$60,621	\$9	(B)	\$60,630
Officer Salaries	\$7,700	0		\$7,700
Employee Benefits	\$63,183	(\$43,217) (\$4,766) (\$1,500)	(C)	\$13,700
Purchased Water	\$14,945	0		\$14,945
Purchased Power	\$15,911	0		\$15,911
Chemicals	0	0		0
Materials/Supplies	\$7,707	(\$4,285)	(D)	\$3,422
Contractual Services- Acct/Legal	\$5,253	0		\$5,253
Water Testing	\$2,011	0		\$2,011
Transportation Exp.	\$11,339	0		\$11,339
Insurance	\$1,089	0		\$1,089
Reg. Com Exp.	\$460	0		\$460
Bad Debt Exp.	\$4,316	(\$4,316)	(E)	0
Misc. Exp	\$35,666	(\$1,404)	(F)	\$34,262
<u>Tot. Utility Expense</u>	<u>\$230,201</u>	<u>(\$59,479)</u>		<u>\$170,722</u>
Depreciation Exp.	\$73,948	\$10,919	(G)	\$84,867
Amortization Exp.	0	\$1,428	(H)	\$1,428
Taxes OTI	\$13,594	(\$8,367)	(I)	\$5,227
<i>Total Op. Expense</i>	<i>\$317,743</i>	<i>(\$55,499)</i>		<i>\$262,244</i>
Net Operating Income	(\$24,172)	\$50,945		\$26,773
Interest Income	\$33	0		\$33
Interest expense	(\$41,657)	\$9,009	(J)	(\$32,648)
Net Income	(\$65,796)	\$59,954		(\$5,842)

Calculation of Revenue Increase:

\$ 262,244– Total Operating Expenses
\$ 67,155 – Debt Service Coverage*
\$ 329,399 – Revenue Requirement
(289,017) – Normalized Revenues
(\$ 33) – Interest Income
\$ 40,349 – Increase (13.96% increase)

* Due to the unavailability of documentation, Western Mason's recommended debt service coverage was calculated using 2004 principal and interest payments on debt approved by the Commission, as follows:

Type	2004 Principal	2004 Interest	Total
Bonds - \$725,000	\$22,000	\$32,056	\$54,056
			X 1.2
			\$64,867
Capital Lease \$6,578	\$1,696	\$592	\$2,288
		Total	\$67,155

This recommendation does not include debt service on a one-year bank loan of \$88,055. This debt was not required to be approved by the PSC under Kentucky statutes, but it was used to pay operating expenses. The PSC normally does not allow recovery of such debt service, finding in prior cases that it constitutes retroactive ratemaking. In addition, some of this debt, since it was used to pay operating expenses, may have paid for expenditures normally disallowed by the PSC, such as family health insurance costs, Christmas bonuses, past-due taxes, etc.

Reference Notes:

- A. Normalized revenues based upon Commission Staff's billing analysis.
- B. Pro forma Salaries Expense based on current salaries of \$39,032 for the manager and \$21,598 for his assistant as of April 2005.
- C. Employee Benefits Expenses were adjusted for three items. First, Western Mason's benefits package includes family health, dental, life and vision benefits. The Commission normally allows the cost of individual employee health insurance, resulting in an adjustment of \$43,217. The other two adjustments were to remove \$1,500 of Christmas bonuses, and to remove FICA taxes, which are allowed on a pro forma basis within Taxes Other Than Income Expense.
- D. Adjustment to remove one capital expenditure of \$4,285 for a Straeffer pump.
- E. Adjustment to remove Bad Debt Expense consistent with past cases.
- F. Adjustment to reduce costs associated with cell phone service.
- G. Pro forma Depreciation Expense was adjusted by \$10,919 to double the depreciation expense on meters. Western Mason has been depreciating meters using a 20-year life (and a 39-year life for meters installed in 1993), although PSC regulations require them to test or replace meters every 10 years. Therefore, Western Mason can justify additional depreciation expense of \$10,919.
- H. Adjustment to allow a 3-year amortization of the Straeffer pump expense removed from Materials and Supplies Expense.

I. Pro forma FICA tax based upon pro forma salaries for the employees and Commissioners of \$68,330 times 7.65%.

J. Normalized Interest Expense on debt approved by the PSC.