

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF MUHLENBERG COUNTY	)	
WATER DISTRICT FOR A GENERAL RATE	)	
ADJUSTMENT PURSUANT TO THE	)	CASE NO.
PROVISIONS OF KRS 278.030 AND 807 KAR	)	2006-00248
5:001	)	

ORDER

On July 7, 2006, Muhlenberg County Water District (“Muhlenberg District”) tendered its application requesting the Commission to approve its proposed increase in its water rates pursuant to Administrative Regulation 807 KAR 5:076. Commission Staff, having performed a limited financial review of Muhlenberg District’s operations, has prepared the attached report containing Staff’s findings and recommendations regarding the proposed rates. All parties should review the report carefully and submit any written comments on Staff’s findings and recommendations or requests for a hearing or informal conference no later than 7 days from the date of this Order.

IT IS THEREFORE ORDERED that:

1. All parties shall, no later than 7 days from the date of this Order, submit written comments, if any, regarding the attached Staff Report or requests for a hearing or informal conference.
2. Any party filing a request for a formal hearing is to include in said request its comments as to the particular finding of the Staff Report to which it objects and a brief summary of testimony it would present at a formal hearing.

3. If no requests for a formal hearing or informal conference are received by this date, this case shall stand submitted to the Commission for a decision on all issues raised by the application.

Done at Frankfort, Kentucky, this 17<sup>th</sup> day of April, 2007.

By the Commission

ATTEST:

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

Executive Director

STAFF REPORT  
ON  
MUHLENBERG COUNTY WATER DISTRICT  
CASE NO. 2006-00248

On July 7, 2006, Muhlenberg County Water District ("Muhlenberg District") submitted its application requesting the Commission to approve its proposed increase in its water rates pursuant to Administrative Regulation 807 KAR 5:076. In its application, Muhlenberg District used the calendar year ending December 31, 2001 as its test period. Ordinarily, Commission Staff ("Staff") would perform a limited financial review of Muhlenberg District's proposed test period operations to evaluate the requested increase in rates. Given that approximately 18 months lapsed between the close of the proposed test-period and the filing date of the Application, Staff believes that the test-period financial information does not adequately represent Muhlenberg District's on-going or future operations. For this reason, Staff performed its limited review on Muhlenberg District's operations for the calendar year ending December 31, 2005.

The Scope of Staff's review was limited to obtaining information as to whether the calendar year 2005 operating revenues and expenses were representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein. Scott Lawless and Mark Frost of the Commission's Division of Financial Analysis performed the limited review on September 21, 2006 and January 18, 2007. Jason Green of the Commission's Division of Financial Analysis is responsible for the pro forma revenue adjustment, the billing analysis, and the calculation of the recommended rates. Scott Lawless and Mark Frost are responsible

for the remaining pro forma adjustments, the calculation of the debt service, and the revenue requirement determination.

Comparisons of Muhlenberg District's actual and pro forma operations for the calendar year 2004 are shown in Appendix A of this report. Based upon Staff's findings and recommendations, Muhlenberg District's pro forma operating statement for the calendar year 2005 would appear as set forth in Appendix B. Discussions of Staff's proposed pro forma adjustments are in Appendix C.

Applying the rates requested by Muhlenberg District to Muhlenberg District's 2005 billing analysis produces a revenue requirement from water rates of \$2,797,325, an increase of \$599,224 or 27.261 percent above Staff's normalized revenue from water rates of \$2,198,101. The rates proposed by Muhlenberg District will increase the average residential bill from \$24.74 to \$31.44, an increase of \$6.70 or 27 percent.

In calculating its revenue requirement, Muhlenberg District used an average annual debt service of \$411,936, which includes the principal and interest payments for Muhlenberg District's proposed bonds that it expected to issue in 2006. As of the date of this Staff Report, Muhlenberg District has not tendered its request to the Commission for authorization to issue its proposed bonds. For this reason the projected debt service payments for the 2006 bonds do not meet the rate making criteria of being known and measurable. In calculating its annual debt service of \$289,460, Staff excluded the debt service for the 2006 bonds.

As shown in Attachment D, Muhlenberg District's 3-year average debt service of \$289,460, Staff's recommended pro forma operations, and a 1.2x debt service coverage, results in a revenue requirement from rates of \$2,565,051, an increase of

\$366,950 or 16.694 percent over Staff's normalized revenue from rates of \$2,198,101. Staff's recommended revenue requirement from rates will allow Muhlenberg District to cover its pro forma operating expenses, meet the debt service requirements, and provide for future equity growth.

Staff has determined that the rates, attached hereto as Appendix E, will generate the annual revenue requirement found reasonable herein of \$2,565,051 and that the rates proposed by Muhlenberg District will produce an amount greater than \$2,565,051. Therefore, Staff recommends the Commission deny the rates proposed by Muhlenberg District and approve the rates contained in Appendix E.

Signatures

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Prepared by: Scott Lawless  
Financial Analyst, Water and Sewer  
Revenue Requirements Branch  
Division of Financial Analysis

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Prepared by: Mark Frost  
Financial Analyst, Water and Sewer  
Revenue Requirements Branch  
Division of Financial Analysis

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

APPENDIX A  
 STAFF REPORT CASE NO. 2006-00248  
 Muhlenberg District'S PRO FORMA INCOME STATEMENT  
 CALENDAR YEAR 2004

	Test-Period Operations	Pro Forma Adjustments	Pro Forma Operations
Operating Revenues:			
Metered Water Sales	\$ 2,051,165	\$ 0	\$ 2,051,165
Sales for Resale	101,465	0	101,465
Other Operating Revenues	73,445	0	73,445
Revenue - Water Sales	<u>\$ 2,226,075</u>	<u>\$ 0</u>	<u>\$ 2,226,075</u>
Operating Expenses:			
Operation & Maintenance:			
Salaries & Wages - Emp.	\$ 630,252	\$ 0	630,252
Salaries & Wages - Com.	18,000	0	18,000
Emp. Pensions & Benefits	277,074	34,311	311,385
Purchased Water	638,163	0	638,163
Purchased Power	44,971	0	44,971
Chemicals	4,211	0	4,211
Materials & Supplies	65,018	0	65,018
Contractual Services - Eng.	2,243	0	2,243
Contractual Services - Acct.	5,125	0	5,125
Contractual Services - Legal	4,800	0	4,800
Contractual Services - Testing	3,896	0	3,896
Contractual Services - Other	0	0	0
Rent - Building/Real Property	0	0	0
Rent - Equipment	2,298	0	2,298
Transportation	41,499	0	41,499
Insurance - Workers Comp.	46,584	0	46,584
Insurance - Other	27,862	0	27,862
Advertising	1,312	0	1,312
Amort. - Rate Case	8,000	(2,000)	6,000
Regulatory Com. Exp.	3,881	0	3,881
Bad Debt	5,084	0	5,084
Misc.	46,928	0	46,928
Total Operation & Maintenance	<u>\$ 1,877,201</u>	<u>\$ 32,311</u>	<u>\$ 1,909,512</u>
Depreciation	271,609	73,577	345,186
Amortization	0	0	0
Taxes Other Than Income:			
PSC Assessment	3,881	0	3,881
Payroll Taxes	50,051	0	50,051
Other Tax & License	0	0	0
Utility Operating Expenses	<u>\$ 2,202,742</u>	<u>\$ 105,888</u>	<u>\$ 2,308,630</u>
Utility Operating Income	<u>\$ 23,333</u>	<u>\$ (105,888)</u>	<u>\$ (82,555)</u>
Other Income & Deductions:			
Interest Income	25,664	(25,664)	0
Net Inc. Available for Debt Service	<u>\$ 48,997</u>	<u>\$ (131,552)</u>	<u>\$ (82,555)</u>

APPENDIX B  
STAFF REPORT CASE NO. 2006-00248  
STAFF'S PRO FORMA INCOME STATEMENT  
CALENDAR YEAR 2005

	Test-Period Operations	Pro Forma Adjustments	Adj. Ref	Pro Forma Operations
Operating Revenues:				
Revenues from Water Sales	\$ 2,186,517	\$ 11,584	(a)	\$ 2,198,101
Other Operating Revenues	70,126	0		70,126
Revenue - Water Sales	<u>\$ 2,256,643</u>	<u>\$ 11,584</u>		<u>\$ 2,268,227</u>
Operating Expenses:				
Operation & Maintenance:				
Salaries & Wages - Emp.	\$ 572,044	\$ 49,498	(b)	621,542
Salaries & Wages - Com.	18,000	0		18,000
Emp. Pensions & Benefits	277,673	96,378	(c)	374,051
Purchased Water	631,849	(42,438)	(d)	589,411
Purchased Power	55,181	0		55,181
Chemicals	4,741	0		4,741
Materials & Supplies	57,238	0		57,238
Contractual Services - Eng.	3,568	0		3,568
Contractual Services - Acct.	5,500	0		5,500
Contractual Services - Legal	4,800	0		4,800
Contractual Services - Testing	3,962	0		3,962
Contractual Services - Other	5,789	0		5,789
Rent - Building/Real Property	683	0		683
Rent - Equipment	1,200	0		1,200
Transportation	48,832	0		48,832
Insurance - Workers Comp.	36,195	2,274	(e)	38,469
Insurance - Other	27,072	(3,233)	(f)	23,839
Advertising	747	0		747
Amort. - Rate Case	8,000	1,085	(g)	9,085
Bad Debt	8,247	0		8,247
Misc.	76,935	6,079	(h)	83,014
Total Operation & Maint.	<u>\$ 1,848,256</u>	<u>\$ 109,643</u>		<u>\$ 1,957,899</u>
Depreciation	280,781	362	(i)	281,143
Amortization	0	0		0
Taxes Other Than Income:				
PSC Assessment	3,718	0		3,718
Payroll Taxes	48,196	3,721	(j)	51,917
Other Tax & License	0	0		0
Utility Operating Expenses	<u>\$ 2,180,951</u>	<u>\$ 113,726</u>		<u>\$ 2,294,677</u>
Utility Operating Income	<u>\$ 75,692</u>	<u>\$ (102,142)</u>		<u>\$ (26,450)</u>
Other Income & Deductions:				
Interest Income	70,248	(63,396)	(k)	6,852
Net Inc. Available for Debt Service	<u>\$ 145,940</u>	<u>\$ (165,538)</u>		<u>\$ (19,598)</u>

APPENDIX C  
STAFF REPORT CASE NO. 2006-00248  
STAFF'S PRO FORMA ADJUSTMENTS

a. Normalized Operating Revenues. In its 2005 Annual Report of Muhlenberg District to the Public Service Commission of the Commonwealth of Kentucky for the Calendar Year Ended December 31, 2005 ("2005 Annual Report"), Muhlenberg District reports revenue from metered water sales of \$2,186,517. On April 16, 2007, Muhlenberg District submitted a billing analysis for the calendar year 2005, showing that the revenues from water sales were actually \$2,198,101, an increase of \$11,584 above the amount that was reported. In reviewing Muhlenberg District's billing analysis, Staff believes that it is reasonable and, therefore, has increased operating revenues by \$11,584.

b. Salaries and Wages Employees. In its 2005 Annual Report, Muhlenberg District reports salaries and wages expense of \$572,044. Muhlenberg District provided an employee schedule listing the test-period wage rates, and the wage rates that became effective April 4, 2006. Using the information from this employee schedule, Staff calculates a pro forma employee salary and wage expense of \$621,542 as shown in Table 1 below. Staff is increasing salaries and wages – employee expense by \$49,498 to reflect the pro forma level of \$621,542.

Table 1: Pro Forma Salaries and Wages Employees				
<u>Title</u>	<u>Payment Form</u>	<u>4/1/2006 Pay Rates</u>	<u>Hours Regular</u>	<u>Pro Forma Salaries &amp; Wages-Emp</u>
Superintendent	Salary	\$ 884.79	N/A	\$ 46,009
Asst. Superintendent	Salary	\$ 756.58	N/A	39,342
Maint Foreman	Salary	\$ 756.58	N/A	39,342
Maint/Operations	Hourly	\$ 13.84	2,080	28,787
Maint/Operations	Hourly	\$ 13.84	2,080	28,787
Meter Reader	Hourly	\$ 13.84	2,080	28,787
Maintenance	Hourly	\$ 13.84	2,080	28,787
Operations	Hourly	\$ 13.84	2,080	28,787
Operations	Hourly	\$ 13.84	2,080	28,787



Operations	Hourly	\$ 13.84	2,080	28,787
Meter Reader	Hourly	\$ 13.84	2,080	28,787
Meter Reader	Hourly	\$ 13.84	2,080	28,787
Meter Reader	Hourly	\$ 13.84	2,080	28,787
Maintenance	Hourly	\$ 14.95	2,080	31,096
Mechanic	Hourly	\$ 14.95	2,080	31,096
Part-Time	Hourly	\$ 14.95	2,080	31,096
Office Manager	Hourly	\$ 14.95	2,080	31,096
Clerical	Hourly	\$ 11.62	2,080	24,170
Clerical	Hourly	\$ 11.62	2,080	24,170
Clerical	Hourly	\$ 11.62	2,080	24,170
Clerical	Hourly	\$ 11.62	1,040	12,085
Pro Forma Totals				\$ 621,542

c. Employee Pensions & Benefits. Muhlenberg District proposes to increase its calendar year 2004 employee pensions and benefits expense of \$277,074 by \$34,311 to reflect the July 1, 2006 County Employee Retirement System ("CERS") employer's mandatory contribution rate of 13.9 percent.

Muhlenberg District reports employee pensions and benefits expense for 2005 of \$277,673. Muhlenberg District provided Staff with a copy of the November 16, 2006 memorandum from the Kentucky Retirement Systems Board of Trustees stating that on July 1, 2007 the CERS employer contribution rate will increase to 16.7 percent. As shown in Table 2 below, Staff used the 16.7 percent CERS contribution rate, the current premiums for the employee insurance benefits, and the current employee level, to calculate a pro forma employee pensions and benefit expense of \$374,051, an increase of \$96,378 above the 2005 expense level. Accordingly, Staff is increasing employee pensions and benefits expense by \$96,378.

<u>Position</u>	<u>CERS</u>	<u>Employee Insurance Benefits</u>			<u>Pro Forma Totals</u>
	<u>Cont.</u>	<u>Health</u>	<u>Dental</u>	<u>Life</u>	
Superintendent	\$ 7,440	\$ 16,013	\$ 199	\$ 638	\$ 24,290
Asst. Superintendent	6,362	17,522	199	1,008	25,091
Maintenance Foreman	6,362	9,471	199	204	16,236

Maint/Operations	4,655	10,496	199	272	15,622
Maint/Operations	4,655	8,074	384	430	13,543
Meter Reader	4,655	13,581	384	214	18,834
Maintenance	4,655	14,279	600	229	19,763
Operations	4,655	17,314	384	603	22,956
Operations	4,655	11,370	384	248	16,657
Operations	4,655	16,740	199	257	21,851
Meter Reader	4,655	17,522	384	800	23,361
Meter Reader	4,655	12,673	384	529	18,241
Meter Reader	4,655	13,830	600	269	19,354
Maintenance	5,028	16,009	199	481	21,717
Mechanic	5,028	17,314	199	763	23,304
Part-Time	5,028	0	0	0	5,028
Office Manager	5,028	8,553	199	356	14,136
Clerical	3,908	9,519	199	326	13,952
Clerical	3,908	15,134	199	336	19,577
Clerical	<u>+ 3,908</u>	<u>+ 16,009</u>	<u>+ 199</u>	<u>+ 422</u>	<u>+ 20,538</u>
Pro Forma Totals	\$ 98,550	\$ 261,423	\$ 5,693	\$8,385	\$ 374,051

d. Purchased Water. In its 2005 Annual Report, Muhlenberg District reports a purchase water expense of \$631,849, and an unaccounted for water loss of 98,308,000 gallons or 19.618 percent. Muhlenberg District's 19.618 percent unaccounted for line loss exceeds the Commission's allowable limit of 15 percent.<sup>1</sup> By limiting line loss to 15 percent, Staff calculates a pro forma purchased water expense of \$589,411,<sup>2</sup> which is \$42,438 below the 2005 level. Accordingly, Staff is reducing purchased water expense by that amount.

<sup>1</sup> 807 KAR 5:066, Section 6(3) limits line loss for rate purposes to 15%.

<sup>2</sup>

Test-Period Water Sales - Gallons	398,884,500
Divided by: Line Loss Reciprocal	÷ 85%
Allowable Water Purchases – Gallons	469,588,824
Purchased Water Rate per Gallon	x \$0.001256
Pro Forma Purchased Water Expense	<u>\$ 589,411</u>

e. Workers' Compensation. In its 2005 Annual Report, Muhlenberg District reports a workers' compensation expense of \$36,195. As shown in Table 3 below, Staff used the workers' compensation rates effective for the period of January 1, 2006 through June 1, 2007 and its recommended pro forma salaries and wages to calculate a pro forma workers' compensation premium of \$38,469, \$2,274 above the 2005 level. Staff is increasing workers' compensation expense by \$2,274.

Table 3: Pro Forma Workers' Compensation Premium			
	Estimated	Rate	
	Payroll	per \$100	Premium
Waterworks Operation & Drivers	\$ 474,755	\$ 5.37	\$ 25,494
Clerical Office Employees (NOC)	\$ 146,787	\$ 0.38	558
Municipal, Township or State Emp	\$ 18,000	\$ 5.44	+ 979
Total Manual Premium			\$ 27,031
Employers' Liability Limits		2.00%	+ 541
Total Manual Premium			\$ 27,572
Experience Modification		44.00%	+ 12,132
Experience Modification			\$ 39,704
Rate Adjustment/Premium Discount		9.528%	- 3,783
Expense Constant			+ 200
Total Estimated Premium			\$ 36,121
Kentucky Special Fund Assessment		6.500%	+ 2,348
Total Pro Forma Workers Comp Exp.			\$ 38,469

f. Insurance. Muhlenberg District records other insurance expense of \$27,072 in its 2005 operating expenses. Upon its review of the 2005 and 2006 invoices, Staff determined that the current insurance premiums are \$23,839, \$3,233 below the recorded amount. Accordingly, Staff is decreasing other insurance expense by \$3,233.

g. Rate Case Amortization. Muhlenberg District proposes to decrease its calendar year 2004 rate case amortization expense of \$8,000 by \$2,000 to eliminate the amortization from its previous rate case and to reflect amortizing its estimated legal fees associated with this current proceeding of \$18,000 over 3 years.

Muhlenberg District reports rate case amortization expense for 2005 of \$8,000. The April 3, 2007 invoice from Damon R. Talley, P.S.C. shows that the actual legal fees incurred to date is \$27,257. By amortizing this amount over 3 years, Staff calculates a rate case amortization expense of \$9,085, \$1,085 above the amount reported in 2005. Accordingly, rate case amortization expense is being increased by \$1,085.

h. Miscellaneous. In reviewing the general ledger and the accountant's workpapers for 2005, Staff determined that miscellaneous expense of \$76,935 was understated by \$8,025. Upon further review Staff notes that \$1,946 of this expense was for employee meals and retirement gifts. Staff believes that Muhlenberg District's employees are adequately compensated and, therefore, Muhlenberg District should not be allowed to recover the \$1,946 of employee related costs through utility rates. Test-period operating expenses have been increased by \$6,079 to correct the error in Annual Report and to disallow the employee expenses.

i. Depreciation. Muhlenberg District proposes to increase its calendar year 2004 depreciation expense of \$271,609 by \$73,577 to reflect depreciation on capital improvement projects that were placed into service in 2005.<sup>3</sup> Staff was provided with a depreciation schedule for the calendar year 2005, which shows that the depreciation expense for this period was \$280,781, an increase of \$9,172 over the amount reported for calendar year 2004. In reviewing Muhlenberg District's 2005 depreciation schedule, Staff notes that the Beach Grove water tank is being depreciated over 25 years. Staff

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<sup>3</sup> Application, Exhibit 13, Proposed Adjustments to Test Period Operations at 3.

believes that a water tank has a life expectancy of longer than 25 years and that a more appropriate depreciation life would be 45 years.

By increasing the depreciation life for the Beach Grove water tank to 45 years and including a full year of deprecation for the utility plant placed into service in 2005, Staff calculates a pro forma depreciation expense of \$281,143, an increase of \$362 above the 2005 level. Depreciation expense is being increased by \$362.

j. Payroll Taxes. In calendar year 2005, Muhlenberg District reports payroll tax expense of \$51,917. Using the pro forma salaries and wages expense, Staff calculates a pro forma payroll tax expense of \$51,917, an increase of \$3,721 over the 2005 level. Accordingly, payroll tax expense has been increased by that amount.

k. Interest Income. Muhlenberg District states that because of its negative cash flows for the period of 2003 through 2006, Muhlenberg District has been forced to use its unrestricted reserve funds to pay debt service and operating expenses. For this reason, Muhlenberg District proposes to eliminate interest income of \$25,664 from its pro forma operations.

In its 2005 Annual Report, Muhlenberg District reports interest income of \$70,248. In reviewing the general ledger, Staff notes that \$63,396 of the interest income is earned on restricted reserve accounts. Staff is reducing interest income by \$63,396 to remove the interest earned on Muhlenberg District's restricted reserves.

APPENDIX D  
STAFF REPORT CASE NO. 2006-00248  
REVENUE REQUIREMENT DETERMINATION

3-Year Average Debt Service	\$ 289,460
Multiplied by: Debt Service Coverage	1.2
Income From Operations	<u>\$ 347,352</u>
Add: Operating Expenses	1,957,899
Depreciation	281,143
Taxes Other Than Income	55,635
Total Revenue Requirement	<u>\$ 2,642,029</u>
Less: Interest & Dividend Income	6,852
Revenue Requirement from Operations	<u>\$ 2,635,177</u>
Less: Forfeited Discounts & Misc. Service Rev.	70,126
Revenue Requirement from Water Sales	<u>\$ 2,565,051</u>
Less: Pro Forma Revenue - Metered Sales	2,198,101
<b>Recommended Increase</b>	<b><u><u>\$ 366,950</u></u></b>
 <b>Percentage Increase</b>	 <u><u>16.694%</u></u>

APPENDIX E  
STAFF REPORT CASE NO. 2006-00248  
STAFF'S RECOMMENDED WATER RATES

**RATES AND CHARGES**

5/8 x 3/4 Inch Connection

First	2,000 gallons	\$	17.53	Minimum bill
Next	8,000 gallons		5.67	per 1,000 gallons
Next	10,000 gallons		5.13	per 1,000 gallons
Next	30,000 gallons		4.61	per 1,000 gallons
Over	50,000 gallons		4.08	per 1,000 gallons

1 Inch Connection

First	5,000 gallons	\$	34.54	Minimum bill
Next	5,000 gallons		5.67	per 1,000 gallons
Next	10,000 gallons		5.13	per 1,000 gallons
Next	30,000 gallons		4.61	per 1,000 gallons
Over	50,000 gallons		4.08	per 1,000 gallons

1-1/2 Inch Connection

First	11,000 gallons	\$	68.03	Minimum bill
Next	9,000 gallons		5.13	per 1,000 gallons
Next	30,000 gallons		4.61	per 1,000 gallons
Over	50,000 gallons		4.08	per 1,000 gallons

2 Inch Connection

First	16,000 gallons	\$	93.71	Minimum bill
Next	4,000 gallons		5.13	per 1,000 gallons
Next	30,000 gallons		4.61	per 1,000 gallons
Over	50,000 gallons		4.08	per 1,000 gallons

3 Inch Connection

First	26,000 gallons	\$	141.90	Minimum bill
Next	24,000 gallons		4.61	per 1,000 gallons
Over	50,000 gallons		4.08	per 1,000 gallons

4 Inch Connection

First	36,000 gallons	\$	187.99	Minimum bill
Next	14,000 gallons		4.61	per 1,000 gallons
Over	50,000 gallons		4.08	per 1,000 gallons

Wholesale		\$	3.16	per 1,000 gallons
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