

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF MEADE COUNTY WATER)	
DISTRICT FOR (1) APPROVAL OF A)	
PROPOSED INCREASE IN RATES FOR)	CASE NO.
WATER SERVICE, (2) APPROVAL OF AN)	2007-00034
INCREASE IN NON-RECURRING CHARGES,)	
AND (3) APPROVAL OF A REVISED TARIFF)	

ORDER

On June 5, 2007, Meade County Water District ("Meade") filed its application for Commission approval of proposed water rates for service, non-recurring charges, and a complete revision of its tariff language. Commission Staff, having performed a limited financial review of Meade's operations, has prepared the attached Report containing its findings and recommendations regarding Meade's application. All parties should review the report carefully and provide any written comments or requests for a hearing or informal conference within 10 days from the date of this Order.

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

Done at Frankfort, Kentucky, this 5th day of September, 2007.

By the Commission

ATTEST:


Executive Director

STAFF REPORT
ON
MEADE COUNTY WATER DISTRICT
CASE NO. 2007-00034

On April 13, 2007, Meade County Water District (“Meade”) applied to increase its rates for water service, adjust to certain existing non-recurring charges, establish new non-recurring charges, and amend its rules and regulations. The Commission did not accept Meade’s application for filing until June 5, 2007, when all filing deficiencies were cured.

To establish the basis for its adjustment to water service rates, Meade determined adjusted historic test year operating revenues and expenses using information from the years 2005 and 2006. Meade’s method is not consistent with KRS 278.192(1) which requires that an historic test year be 12 consecutive calendar months. An in-depth discussion of Meade’s test year is provided in Attachment A of this report. Utilizing the adjusted test year as a basis for its application, Meade determined its revenue requirement from water service rates to be \$1,702,253, an increase of \$64,565 or 3.94 percent over normalized test year revenues from water service rates of \$1,637,689.

Meade allocated its requested \$1,702,253 revenue requirement from water service rates to its different meter sizes through the cost of service study provided in Exhibits 6, 7, and 8 of its application to determine its requested rates from water service. Using Meade’s proposed rates, a residential customer’s monthly bill for use of

5,000 gallons would be \$38.83, a \$1.73, or 4.66 percent, increase over current rate charge of \$37.10.

To review Meade's application Staff conducted a field review to gather information concerning Meade's test year operations and the pro forma information presented in its application. Staff's review is limited to determining whether the test year and pro forma financial information presented by Meade in its Application is representative of normal operations. All pro forma adjustments to test-year operations must be known and measurable pursuant to 807 KAR 5:001, Section 10(7). Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

This report summarizes Staff's review and recommendations. Jack Scott Lawless is responsible for the revenue requirement determination while Eddie Beavers determined pro forma revenues, and reviewed the non-recurring charge cost justification sheets and the tariff revision.

Attachment A of this report details Meade's pro forma adjusted operating income statement. Staff's adjusted income statement and an explanation of Staff's proposed adjustments to test year operations is found at Attachment B.

A comparison of the revenue requirement calculations of Commission Staff and Meade is found at Attachment C. Staff calculated Meade's revenue requirements from water service rates to be \$1,599,068, a decrease of \$15,542, or .96 percent, from normalized revenues from water service rates of \$1,614,610. Considering that Meade's current rates produce revenues nearly equal to this revenue requirement, Staff recommends that the Commission deny the proposed adjustment.

Meade proposed the following changes to its non-recurring charges.

	Current	Proposed
5/8" Tap Fee	\$500	\$632
1" and Above Tap Fee	Actual Cost	Actual Cost
Connection/Turn-On Fee	0	25
Field Visit	0	25
Customer Request Meter Re-Read	0	25
Service Call/Investigation	0	25
Returned Check Charge	0	25
Customer Request Meter Relocation	0	Actual Cost
Customer Request Meter Test	5	50
Reconnect/Disconnect for Non-Payment	15	50
Connection/Turn-On Fee After Hours	0	50
Customer Request Meter Re-Read After Hours	0	50
Service Call/Investigation After Hours	0	50
Meter Tampering Charge	0	50
Late Payment Penalty	10%	10%
Credit Card Convenience Charge	0	.10

Meade provided cost justification sheets for each fixed, non-recurring charge.

Those charges that are stated at actual cost are for services that can vary greatly from one customer to another and thus are appropriate for actual cost recovery. Staff has reviewed the cost justification sheets and finds, except for the credit card convenience charge, these sheets to provide sufficient evidence for the proposed adjustments. Staff recommends that the Commission approve the proposed non-recurring charges except the credit card convenience charge.

Meade's current tariff includes rules and regulations that date to 1987. Meade has proposed a total revision to these rules and regulations to update them with existing statutes and regulations of the Commonwealth of Kentucky. Staff has reviewed the proposed tariff, finds it appropriate, and recommends that it be approved by the Commission.

Signatures:

Prepared by: Jack Scott Lawless, CPA
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. 2007-00034
MEADE'S REQUESTED ADJUSTED OPERATIONS

	Test Year		Pro Forma
	Per		Application
	Audit	Adjustments	Exhibit 5
	2006		
Operating Revenue			
Water Sales	\$ 1,587,836	\$ (1,865)	
		51,718	\$ 1,637,689
Other Operating Revenue			
Penalties	32,600	(32,600)	0
Miscellaneous Service Revenues	5,265	(5,265)	0
Total Other Operating Revenues	37,865	(37,865)	0
Total Operating Revenue	1,625,701	11,988	1,637,689
Operating Expenses			
Operation and Maintenance			
Salaries and Wages - Employees	363,612	(108,920)	254,692
Salaries and Wages - Commissioners	18,300	(2,352)	15,948
Employee Pensions and Benefits	89,655	21,857	111,512
Purchased Water	379,290	(7,623)	371,667
Purchased Power	18,683	(591)	18,092
Materials and Supplies	71,676	(15,340)	56,336
Contractual Services - Accounting	5,000	0	5,000
Contractual Services - Legal	863	(464)	399
Contractual Services - Water Testing	4,217	(36)	4,181
Contractual Services - Other	47,041	(11,604)	35,437
Transportation Expenses	29,517	9,791	39,308
Insurance - Other	31,812	(7,214)	24,598
Advertising Expenses	617	(15)	602
Bad Debt	8,032	(3,232)	4,800
Miscellaneous Expenses	16,555	41,438	57,993
Total Operation and Maintenance	1,084,870	(84,305)	1,000,565
Taxes Other Than Income	76,705	82,286	158,991
Depreciation	318,256	(16,752)	301,504
Amortization	966	(966)	0
Total Operating Expenses	1,480,797	(19,737)	1,461,060
Net Operating Income	144,904	31,725	176,629
Plus: Interest Income	31,964	(11,716)	20,248
Income Available to Service Debt	\$ 176,868	\$ 20,009	\$ 196,877

Meade's 2006 audit report was not complete at the time Meade prepared its application. Meade determined its pro forma operating revenues using the billing analysis included in its application at Exhibit 6. Meade established pro forma operating expenses using unaudited, cash basis operation and maintenance and taxes other than income taxes expenses for 2006 and audited depreciation expense for 2005.

Meade's audit has since been completed. To compare the audited financial information to Meade's requested pro forma operations, Staff compiled the pro forma statement shown above. Based upon this comparison it appears as though Meade has proposed many large adjustments to various expense accounts but the majority of these adjustments are merely the result of Meade using cash basis financial information in the pro forma. For example, pro forma salaries and wages as stated by Meade includes only net pay to each employee with the employees portion of payroll taxes reported as tax expense of Meade. The audited, or test year as shown in this comparison, salaries and wages are properly stated at gross wages and only Meade's portion of the payroll taxes are reported as tax expense. The adjustments shown to these accounts are simply the differences in the test year and pro forma amounts shown on the schedule.

The comparison does show that Meade proposes an overall increase to 2006 audited Income Available to Service Debt by \$20,009. Staff's adjustments to the 2006 audited financial statements are shown and discussed in Attachment B with little regard to the adjustments shown in Attachment A.

ATTACHMENT B
STAFF REPORT 2007-00034
STAFF'S ADJUSTED OPERATIONS

	Test Year			
	Per			
	Audit			
	2006	Adjustments	Ref.	Pro Forma
Operating Revenue				
Water Sales	\$ 1,587,836	\$ (1,865)	(A)	
		28,639	(B)	\$ 1,614,610
Other Operating Revenue				
Penalties	32,600		(C)	32,600
Miscellaneous Service Revenues	5,265	47,560	(D)	52,825
Total Other Operating Revenues	37,865	47,560		85,425
Total Operating Revenue	1,625,701	74,334		1,700,035
Operating Expenses				
Operation and Maintenance				
Salaries and Wages - Employees	363,612	21,436	(E)	385,048
Salaries and Wages - Commissioners	18,300			18,300
Employee Pensions and Benefits	89,655	30,060	(F)	119,715
Purchased Water	379,290	6,724	(G)	386,014
Purchased Power	18,683	285	(G)	18,968
Materials and Supplies	71,676			71,676
Contractual Services - Accounting	5,000			5,000
Contractual Services - Legal	863			863
Contractual Services - Water Testing	4,217			4,217
Contractual Services - Other	47,041			47,041
Transportation Expenses	29,517			29,517
Insurance - Other	31,812			31,812
Advertising Expenses	617			617
Bad Debt	8,032			8,032
Miscellaneous Expenses	16,555	(238)	(H)	16,317
Total Operation and Maintenance	1,084,870	58,267		1,143,137
Taxes Other Than Income	76,705	(43,074)	(I)	33,631
Depreciation	318,256	(38,926)	(J)	279,330
Amortization	966			966
Total Operating Expenses	1,480,797	(23,733)		1,457,064
Net Operating Income	144,904	98,067		242,970
Plus: Interest Income	31,964			31,964
Income Available to Service Debt	\$ 176,868	\$ 98,067		\$ 274,934

(A) Sales of Water – Billing Analysis. In its 2006 annual report Meade reported Sales of Water at \$1,625,701. This amount includes not only revenues derived from water service rates but also Other Operating Revenues collected through assessment of the non-recurring charges included in Meade's tariff. Test year Other Operating Revenues totaled \$37,865 and consisted of late payment penalties and reconnection fees of \$32,600 and \$5,265, respectively. Staff has separated these revenues from Sales of Water in its pro forma operating statement, leaving the proper amount reported in Sales of Water at \$1,587,836.

At Exhibit 6 of its Application, Meade provided a summary of its test year billing analysis. The billing analysis states test year water sales as \$1,585,971. Staff has reviewed Meade's proposed billing analysis, concurs with its methodology and findings, and has decreased test year Sales of Water by \$1,865 (Billing Analysis \$1,585,971 - Test Year \$1,587,836) to state pro forma Sales of Water equal to the billing analysis results.

(B) Sales of Water – Customer Growth. Meade proposed to increase test year Sales of Water by \$51,718 to account for additional water sales to be collected from the 132 new customers added to Meade's distribution system during the test year. To calculate its adjustment, Meade first determined the average monthly revenue derived from an average residential customer by applying its current rates for water service to the average test year usage of a residential customer, 4,410 gallons. This average revenue was then applied to the number of customers added during the test year and annualized.

During its review, Staff discovered that Meade added 160 new customers to its distribution system throughout the test year. Staff calculated an increase to test year sales of \$28,639 to annualize water sales from these partial year customers. Staff calculated the adjustment using the average monthly residential usage of 4,410 gallons per customer as used by Meade.

Even though Staff's adjustment for customer growth reflects more new customers than Meade's adjustment, it is less because Meade's adjustment adds 12 months of revenue for each of the 132 customers included in the adjustment. In making its adjustment, Meade assumes that all 132 customers were added subsequent to the test year and that no test year revenue was derived from these customers. This is not the case. Staff's adjustment considers the actual month that each new customer began receiving water service. Staff's adjustment more accurately reflects additional water sales from customer growth.

(C) Late Payment Penalties. As previously discussed, during the test year Meade collected late payment penalties totaling \$32,600. Meade essentially eliminated this amount from pro forma revenues by stating total pro forma operating revenues equal to the sales of water revenue calculated in its billing analysis. This treatment of penalties is inappropriate. The revenue derived from the collection of late payment penalties is recurring. It should be included in pro forma revenues and used to offset Meade's total revenue requirements. Staff recommends that the test year amount of \$32,600 be included in pro forma Other Operating Revenue.

(D) Miscellaneous Service Revenue. As previously discussed, during the test year Meade collected reconnection fees totaling \$5,265. Staff has reported this revenue in

Miscellaneous Service Revenue. Meade essentially eliminated this amount from pro forma revenues by stating total pro forma revenues equal to the sales of water revenues calculated in its billing analysis. This treatment of reconnection fees is inappropriate. The revenue derived from the collection of reconnection fees is recurring. It should be included in pro forma revenues and used to offset Meade's total revenue requirements. Furthermore, the test year amount should be increased to reflect Meade's proposed reconnection fee.

The current reconnection fee is \$15 per occurrence. Staff recommends Commission approval of Meade's proposed reconnection fee of \$50. The proposed fee represents a 233.33 percent increase in the reconnection fee which will result in an equal percentage increase in test year revenue derived from the charge. Staff has therefore increased test year Miscellaneous Service Revenues by \$12,285 (Test Year Revenue \$5,265 x Percentage Increase 233.33) to account for the increase in this charge.

Staff further recommends that Miscellaneous Service Revenues be increased by an additional \$35,275 to reflect proposed increases to Meade's other non-recurring charges. Staff calculated its adjustment by multiplying the amount of the recommended charges to the number of anticipated annual occurrences of each charge. The actual number of test year occurrences was used for the returned check charge but estimates made by Meade's employees were used for the remaining charges as there is no record of actual occurrences. This portion of the adjustment is detailed below.

			Occurrences	Charge	Revenue
Connection/Turn On			240	\$ 25	\$ 6,000
Field Visit			780	25	19,500
Customer Request Meter Re-Read			60	25	1,500
Service Call Investigation				25	-
Returned Check			61	25	1,525
Customer Request Meter Relocation					-
Customer Request Meter Test			20	50	1,000
Connection/Turn On After Hours			35	50	1,750
Customer Request Meter Re-Read After Hours				50	-
Service Call/Investigation After Hours			60	50	3,000
Meter Tampering Charge			20	50	1,000
					\$ 35,275

The total adjustment to Miscellaneous Service Revenues is then \$47,560 (\$12,285 + \$35,275).

(E) Salaries and Wages – Employees. Meade reported test year Salaries and Wages – Employees of \$363,612. Staff recommends that the test year amount be increased by \$21,436 to state the pro forma expense at \$385,048. Staff determined its adjustment by applying current wage rates for all current employees to test year regular and over-time hours worked. If new employees were hired subsequent to the test year to replace a former employee, the new employee’s wage rate was applied to the former employee’s test year hours. Otherwise, Meade estimated the hours to be worked by new employees.

(F) Employee Pensions and Benefits. Test year employee pensions and benefits were reported at \$89,655. The test year consists of pension contributions and health insurance in the amounts of \$40,978 and \$48,677, respectively.

Meade participates in the County Employees Retirement System and makes contributions based upon full-time employee wages. Meade has been notified by the retirement system that the rate to be contributed by the employer for the fiscal year

ending June 30, 2008, will be 16.17 percent. This employer contribution is in addition to the 5 percent contribution made by the employee. Staff recommends that test-year expenses be increased by \$21,284 as calculated below to account for the contribution rate increase.

Pro forma wages				\$	385,048
Times: Contribution rate effective 7/1/07					16.17%
Pro forma retirement					62,262
Less: Test year retirement					(40,978)
Increase for retirement				\$	21,284

Meade pays a portion of employee health and life insurance benefits. The following adjustment is recommended by Staff to reflect the most recent insurance premium information available at the time of Staff's review.

Monthly health insurance paid by Meade				\$	4,598
Monthly life insurance paid by Meade					190
Total monthly health and life insurance premium					4,788
Annualize					12
Pro forma					57,453
Less: Test year insurance					(48,677)
Increase for insurance				\$	8,776

The net increase to test year Employee Pensions and Benefits is then \$30,060.

(G) Purchased Water and Power. Staff recommends that Purchased Water and Purchased Power be increased by \$6,724 and \$285, respectively, to account for the increase in these expenses resulting from the increased water sales volume included in the customer growth revenue adjustment previously discussed by Staff. Calculations of these adjustments are detailed below. Note that the purchased water adjustment also includes \$902 for additional meter charges that result from two new points of wholesale

delivery from Hardin County Water District that were connected to Meade's distribution system subsequent to the test year.

Gallons used to normalize sales				3,858,750
Divide by: 1-water loss percentage of 7.87 percent				92.13%
Additional gallons necessary to purchase for normalized sales				4,188,578
Cost per 1,000 from Hardin County Water District				\$ 1.39
Increase to purchased water for additional purchases needed to normalize sales				5,822
Additional meter charges resulting from main extension project				902
Total Increase in Purchased Water				\$ 6,724
Test year purchased power expense				\$ 18,683
Divide by: Test year water purchases, 1,000 gallons				274,143
Purchased power expense per 1,000 gallons of purchased water				0.068150638
Times: Additional gallons to be purchased to normalize revenues				4,189
Total Increase in Purchased Power				\$ 285

(H) Miscellaneous Expense. During its review Staff discovered expenses totaling \$238, as detailed below, charged to Miscellaneous Expense that should have been charged to account 426 – Miscellaneous Nonutility Expenses. Staff has decreased test year operating expenses by \$238 to reclassify this amount and move these expenses below the line.

Date	Vendor	Check #	Amount
1/19/06	Pat's Florist	8149	\$ (53)
4/3/06	Meade Co. Chamber of Commerce	8278	(185)
Total			\$ (238)

(I) Taxes Other Than Income. For the test year Meade reported Taxes Other Than Income Taxes of \$76,705 consisting of FICA taxes, school taxes, sales taxes, and unemployment taxes in the amounts of \$28,722, \$41,602, \$3,112, and \$3,269, respectively.

Staff has increased the test year amount by \$1,640 to match pro forma FICA taxes with the pro forma Salaries and Wages adjustment recommended by Staff. Detail of the adjustment is shown below.

Increase to salaries and wages				\$	21,436
Times: FICA tax rate					7.65%
Increase				\$	1,640

Staff decreased the test year amount by \$44,714 to eliminate school and sales taxes from test year expenses. Meade assesses both of these taxes by applying the tax rates to customer bills. These taxes are collected in addition to the customer billings calculated using Meade’s tariff. Meade acts only as a collection agency for the taxing authorities. The tax collections are not reported as revenues by Meade. Likewise, the payment of such taxes should not be included in Meade’s expenses.

Staff’s net adjustment to Taxes Other Than Income is a decrease of \$43,074 (\$1,640 - \$44,714).

(J) Depreciation Expense. Meade reported test year depreciation expense of \$318,256. The depreciable lives assigned to Meade’s utility plant in service accounts are consistent with those recommended by the National Association of Regulatory Utility Commissioners (“NARUC”) except the 40-year life assigned to transmission and distribution mains. NARUC recommends a life range of 50 to 75 years for transmission and distribution mains.

In recent cases where this issue was present, Staff recommended a life of 65 years, roughly the average life recommended by NARUC. However, in this case Staff has applied a life of 50 years since the rates for water service currently charged by

Meade are adequate to fund depreciation at this rate. This life is shorter than used by Staff in previous cases but still falls within the NARUC recommended range.

Staff has decreased test year depreciation expense by \$38,926 to account for this change in accounting estimate. Staff calculated the adjustment, as shown below, by applying straight-line, remaining-life depreciation to the main's net book balance at the end of the test year.

	Original	Reassigned		Remaining		Annual
	Useful	Useful		Life Based		Depreciation
Year In	Whole	Whole	Age at	on Reassigned	Undepreciated	Based on
Service	Life	Life	12/31/2006	Useful	Balance at	Remaining
				Whole Life	12/31/2006	Life
1987	40	50	20	30	504,967	16,832
1989	40	50	18	32	42,051	1,314
1990	40	50	17	33	44,285	1,342
1992	40	50	15	35	110,102	3,146
1993	39	50	14	36	16,210	450
1993	40	50	14	36	59,095	1,642
1994	40	50	13	37	40,644	1,098
1995	40	50	12	38	527,428	13,880
1996	40	50	11	39	163,813	4,200
1997	40	50	10	40	127,292	3,182
1998	40	50	9	41	87,642	2,138
1999	40	50	8	42	45,991	1,095
2000	40	50	7	43	37,864	881
2001	40	50	6	44	1,655,641	37,628
2002	40	50	5	45	650,646	14,459
2003	40	50	4	46	20,791	452
2004	40	50	3	47	109,877	2,338
2005	40	50	2	48	102,703	2,140
2006	40	50	1	49	513,713	10,484
Total					4,860,756	118,700
Less: Test Year						(157,626)
Decrease						(38,926)

ATTACHMENT C
STAFF REPORT CASE NO. 2007-00034
COMPARISON OF REVENUE REQUIREMENT DETERMINATION

	Meade	Staff	Difference
Pro Forma Operating Expenses	\$ 1,461,060	\$1,457,064	\$ (3,996)
Debt Service Requirement			
Annual Principal and Interest Payments, 3 year average 2007-2009			
1992 Rural Development Revenue Bonds		24,050	
2005 Kentucky Infrastructure Authority Loan #F03-05		26,404	
2001 Kentucky Rural Water Finance Corporation		46,385	
2004 Kentucky Infrastructure Authority Loan #C98-05		15,467	
1995 Kentucky Association of Counties Lease		64,254	
2002 Kentucky Association of Counties Lease		33,682	
Debt Principal per 2005 Audit, See Application, Exhibit 5, Page 2	98,786		
Interest, See Application, Exhibit 5, Page 2	119,083		
Total Principal and Interest	217,869	210,241	
Debt Coverage at 20 percent of Annual Principal and Interest	43,574	42,048	
Loan Servicing Fees		7,103	
Total Debt Service Requirement	261,443	259,392	(2,050)
Total Revenue Requirement = Operating Expenses + Debt Service	1,722,503	1,716,456	(6,046)
Less: Other Operating Revenue	-	(85,425)	(85,425)
Interest Income	(20,248)	(31,964)	(11,716)
Total Revenue Required from Rates for Service	1,702,255	1,599,068	(103,187)
Less: Normalized Present Rate Revenue	(1,637,689)	(1,614,610)	23,079
Required Revenue Increase/Decrease	\$ 64,566	\$ (15,542)	\$ (80,108)
Percentage Increase/Decrease	3.94%	-0.96%	

To determine Meade's revenue requirement Staff added the pro forma operating expenses as presented in Attachment B to Meade's debt service requirement. Staff then deducted other operating income and interest income to determine the revenue required from sales of water.

To determine its debt service requirement, Meade added principal retirements from 2005 to interest payments from 2006 and applied the sum to the 20 percent coverage requirement of its Rural Development Revenue Bonds.

Staff calculated Meade's debt service requirement by applying the 20 percent coverage requirement to the three-year average debt principal and interest payments for the years 2007 through 2009 and adding the annual loan servicing charges. Staff's method more accurately reflects the debt payments required of Meade while the rates for water service are in effect.