

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

PROPOSED ADJUSTMENT OF THE WHOLESALE)
WATER SERVICE RATES OF FRANKFORT) CASE NO. 2008-00250
ELECTRIC AND WATER PLANT BOARD)

ORDER

The Frankfort Electric and Water Plant Board (“Plant Board”) proposes to adjust the rate of wholesale water service to five water districts and a water association from \$1.539 per 1,000 gallons to \$1.814 per 1,000 gallons, an increase of 17.9 percent. By this Order, the Commission denies the proposed adjustment and authorizes the Plant Board to increase its wholesale water service rate to \$1.704 per 1,000 gallons.

BACKGROUND

Frankfort, a city of the second class,¹ provides utility services through the Plant Board, a combined electric and water utility plant. The Plant Board serves approximately 16,000 retail water customers in the Frankfort area.² In addition, it provides wholesale water service to the Georgetown Municipal Water and Sewer Service (“Georgetown”) and six public utilities: Elkhorn Water District; Farmdale Water District; North Shelby Water Company; Peaks Mill Water District; South Anderson Water

¹ KRS 81.010(2).

² Gannett Fleming, Inc., *The Electric and Water Plant Board of the City of Frankfort, Kentucky Water Division Cost-of-Service Study as of June 30, 2007 and Proposed Customer Rates*, Schedule C at 15 (Feb. 14, 2008) (hereinafter “Gannett Fleming Study”). All references to the Gannett Fleming Study in this Order incorporate the amended pages filed with the Commission on August 27, 2008.

District; and U.S. 60 Water District. Of these six public utilities, North Shelby Water Company is the only water association and is organized under KRS Chapter 273. The other five entities are all water districts organized under KRS Chapter 74. The six public utilities are subject to Commission jurisdiction.³

On June 6, 2008, the Plant Board provided notice to the Commission and its customers of its intent to increase the wholesale rate, which was to be effective on July 7, 2008. The Plant Board initially proposed to increase its wholesale rate from \$1.539 per 1,000 gallons to \$1.822 per 1,000 gallons. Four of the six public utilities (Elkhorn Water District, North Shelby Water Company, Peaks Mill Water District, and U.S. 60 Water District [collectively, "the Intervenors"]) served by the Plant Board requested that the Commission suspend the rate for an investigation of reasonableness and sought intervention in the case.⁴ The Commission established this proceeding and suspended the Plant Board's proposed rate, pursuant to KRS 278.190.

On August 27, 2008, the Plant Board identified an error in its calculation of water main length used in the cost-of-service study. The allocation factors in the cost-of-service study changed as a result of the corrected inputs and, ultimately, the corrected calculations changed the proposed rate to \$1.814 per 1,000 gallons, instead of the initial proposed rate of \$1.822 per 1,000 gallons.⁵

³ KRS 278.010(d); KRS 278.012; KRS 278.015; KRS 278.040.

⁴ Although Farmdale Water District and South Anderson Water District are not parties to this case, the rate suspension prevented the Plant Board from implementing the proposed rate to any of the six wholesale customers.

⁵ See Letter from John H. Hughes, Counsel for the Plant Board, to Stephanie Stumbo, Executive Director, Public Service Commission at 2 (Aug. 27, 2008); Brief of Frankfort Electric and Water Plant Board at 1 (filed Mar. 11, 2009).

The statutory rate suspension period ended on December 8, 2008, and the Plant Board placed the \$1.822-per-1,000-gallons rate in effect on that date, subject to refund pursuant to KRS 278.190. Each of the Intervenor's increased its rates commensurate with the Plant Board's increase, pursuant to KRS 278.012, KRS 278.015, and 807 KAR 5:068.⁶

On February 17, 2009, after conducting discovery, the Commission held an evidentiary hearing at which all the parties were present. The Plant Board presented the testimony of its general manager, Warner Caines, and the author of its cost-of-service study, Paul Herbert of Gannett Fleming. It also made available for questions its chief water engineer, David Billings, and its finance director, Shannon Taylor. The Intervenor's did not present any witnesses. Following the parties' submission of written briefs, this matter stood submitted for decision on March 11, 2009.

LEGAL STANDARDS

As a municipal utility, the Plant Board is not generally subject to Commission jurisdiction because KRS 278.010 excludes cities from the definition of "utility." The Kentucky Supreme Court carved an exception to the exclusion of cities under Commission jurisdiction in *Simpson County Water District v. City of Franklin*, 872 S.W.2d 460 (Ky. 1994). The *Simpson County* case effectively requires all municipal utility transactions with a public utility to comply with the provisions of KRS Chapter 278

⁶ Case No. 2008-00516, *Purchased Water Adjustment of North Shelby Water Company* (Ky. PSC Jan. 14, 2009); Case No. 2008-00552, *Purchased Water Adjustment of Peaks Mill Water District* (Ky. PSC Jan. 22, 2009); Case No. 2008-00557, *Purchased Water Adjustment of U.S. 60 Water District* (Ky. PSC Jan. 22, 2009); Case No. 2009-00003, *Purchased Water Adjustment of Elkhorn Water District* (Ky. PSC Feb. 5, 2009).

and makes Commission approval a prerequisite to any change in a rate that a municipal utility assesses a public utility for wholesale utility service.

The Commission reviews rates to ensure that they are fair, just, and reasonable.⁷ The Plant Board has “the burden of proof to show that the increased rate or charge is just and reasonable.”⁸

ANALYSIS

Test Period

The Plant Board proposes and the Commission accepts the 12-month period ending June 30, 2007 as the test period for determining the reasonableness of the proposed rate. In using this historic test period, the Commission has given full consideration to appropriate known and measurable changes.

Operating Expenses

1. Clubhouse Expenses

The Plant Board maintains a clubhouse that it uses for office functions, and the clubhouse is available to the public for events. The Plant Board included \$2,630 in expenses for the clubhouse, \$301 of which is allocated to the wholesale customers.⁹ The Intervenor initially suggested that expenses related to the clubhouse should not be allocated to the wholesale customers. The Plant Board responded that the revenues generated from the clubhouse make up for the expenses.¹⁰ In addition to this fact, the

⁷ KRS 278.030.

⁸ KRS 278.190(3).

⁹ Gannett Fleming Study, *supra* note 2, Schedule B at 3.

¹⁰ Plant Board's Response to Peaks Mill Water District's First Set of Interrogatories, Item 22 (filed Sept. 19, 2008).

Plant Board holds meetings and training for its staff at the clubhouse.¹¹ Accordingly, the Commission finds that it is appropriate to allocate expenses related to the clubhouse to the Plant Board's wholesale customers.

2. Capital Projects Expenses

The Plant Board has included \$1,136,245 for capital projects in the test period. This reflects the anticipated cost of future projects. The Commission typically uses the amount calculated for depreciation instead of the capital projects account because depreciation represents the systematic recovery of the utility's actual investment in prior capital projects. Unlike projections for future capital projects, depreciation is both a known and measurable quantity. In addition, utilization of depreciation expense ensures that current ratepayers do not have to pay for future projects for which they might not receive benefit. Accordingly, the Commission finds that a reasonable portion of the depreciation expense of \$1,079,650 should be allocated to the wholesale customers instead of the capital projects expense.

3. Payments in Lieu of Taxes

The Plant Board included \$48,998 for payments in lieu of taxes, \$10,713 of which was allocated to the wholesale customers. The Plant Board has not provided any evidence to demonstrate that it is required to make these payments.¹² In addition, it has not presented any evidence that it receives any benefit or service for those payments. The American Water Works Association's M1 Manual states that the appropriateness of

¹¹ Transcript at 34.

¹² Three of the Plant Board's witnesses at the hearing were asked questions related to local taxes. Two witnesses disclaimed knowledge regarding the taxes in general, and another witness did not know whether the payments were legally required. Transcript at 32, 77, 162.

allocating these expenses may be addressed by regulatory agencies, and that “[s]ome commissions only allow payments for actual services received.”¹³ Because the Plant Board has not demonstrated that these payments are required and has not shown that they provide any benefit to the wholesale customers, the payments should not be allocated to the wholesale customers.

4. Rate Case Expenses

The Plant Board initially sought to recover \$68,000 worth of expenses related to the rate case. This figure represented an estimated cost of the cost-of-service study plus other expenses related to this proceeding.¹⁴ At the hearing, counsel for Commission Staff requested that the Plant Board provide an “itemized list and invoices” for all expenses that the Plant Board sought to include in the rate case.¹⁵

In its post-hearing responses, the Plant Board identified the following expenses:¹⁶

Cost-of-Service Study	\$25,726.61
Outside Counsel	18,062.48
Gannett Fleming Hearing Expenses	25,621.54
Plant Board Staff Time	6,831.19
Miscellaneous	<u>2,288.32</u>
Total	\$78,405.14

The Plant Board, however, failed to provide invoices for most of these expenses. It provided an invoice from Gannett Fleming which identifies charges for “Water Cost of

¹³ American Water Works Association, *Principles of Water Rates, Fees, and Charges* at 25 (5th ed. 2000) (hereinafter “AWWA M1 Manual”).

¹⁴ Transcript at 165.

¹⁵ *Id.* at 166.

¹⁶ See Plant Board’s Response to Intervenors’ and PSC February 18, 2009 Data Request, Item 8 (filed February 27, 2009); Brief of Frankfort Electric and Water Plant Board at 17 (filed Mar. 11, 2009). There are discrepancies between the amounts listed in these two documents. The amounts listed in this Order reflect the highest figures identified by the Plant Board.

Service Study” in the amount of \$13,107.98.¹⁷ It also provided a detailed invoice from its outside counsel in the amount of \$18,062.48.¹⁸

The Commission does not permit expenses that are inadequately documented.¹⁹ As the proponent of the rate adjustment, the Plant Board bears the burden of demonstrating the reasonableness of the expenses that it seeks to include in the proposed wholesale rate. In failing to submit detailed invoices in support of the claimed expenses, it has failed to meet this burden. Accordingly, we find that only the expenses for which invoices were supplied should be recovered in rates. With respect to the costs associated with the Plant Board staff time, we further find that these costs are not recoverable because the wages and salaries of Plant Board personnel have already been included. To find otherwise would be to permit double recovery of these expenses.²⁰

Allocation of Costs

1. Transmission and Distribution Lines

The Intervenors contend that the Plant Board incorrectly allocated costs associated with water lines that are not necessary to provide service to the wholesale

¹⁷ Brief of Frankfort Electric and Water Plant Board at Ex. 1 (filed Mar. 11, 2009).

¹⁸ Plant Board’s Response to Intervenors’ and PSC February 18, 2009 Data Request, Item 8, Ex. 1 (filed February 27, 2009).

¹⁹ See, e.g., Case No. 2008-00364, *Application for Rate Adjustment of Ridgelea Investments, Inc. Pursuant to the Alternative Rate Adjustment Procedure for Small Utilities* (Ky. PSC Dec. 8, 2008) (adopting the recommendation of the Staff Report entered on October 14, 2008); Case No. 2001-00211, *Application of Hardin County Water District No. 1 for: (1) Issuance of Certificate of Public Convenience and Necessity, (2) Authorization to Borrow Funds and to Issue Its Evidence of Indebtedness Therefor, (3) Authority to Adjust Rates, and (4) Approval to Revise and Adjust Tariff*, at 19 (Ky. PSC Mar. 1, 2002).

²⁰ Allocation of the rate case expenses is discussed below.

customers.²¹ They argue that all the expenses associated with lines less than 10 inches in diameter that do not directly serve any wholesale customer should be excluded from the revenue requirements allocated to the wholesale customers.²² In addition, the Intervenor has identified several other larger lines that serve only Georgetown Municipal Water and Sewer Service, and they maintain that costs associated with these lines should also be excluded from the wholesale rate calculations.²³

The Commission has ordered expenses related to lines less than 10 inches in diameter to be excluded from any allocation to the wholesale customers in previous cases. In Case No. 2002-00022,²⁴ Mountain Water District challenged the proposed rates of the city of Pikeville. The Commission rejected Pikeville's cost-of-service study because it had several significant flaws, and it accepted Mountain Water District's study that was based on the inch-mile method by which expenses are allocated to a wholesale customer based on the length and size of line that benefits each customer classification. In *Pikeville*, the Commission required that expenses for lines smaller than 10 inches in diameter not be allocated to the wholesale customers.

Unlike the cost-of-service study used to support Pikeville's rates, the Gannett Fleming Study uses the base-extra capacity methodology. Under this methodology, costs of service are generally separated into base costs, extra capacity costs, customer

²¹ Brief of North Shelby Water Company and U.S. 60 Water District at 2 (filed Mar. 11, 2009).

²² *Id.* at 3-4.

²³ *Id.* at 1-2.

²⁴ Case No. 2002-00022, *Proposed Adjustment of Wholesale Water Service Rates of the City of Pikeville, Kentucky* (Ky. PSC Oct. 18, 2002).

costs, and direct fire protection costs.²⁵ Base costs tend to vary with the total quantity of water used for a constant or average annual rate of use. These costs include operation and maintenance expenses of supply, treatment, pumping, and distribution facilities.

Extra capacity costs are costs incurred in meeting rate-of-use requirements in excess of the average and include operation and maintenance expenses and capital costs for system capacity required for above-average usage.

Customer costs are costs associated with serving customers regardless of the amount of water used. These include meter reading and billing and other administrative expenses, as well as the maintenance and capital costs related to meters and services.

Fire protection costs are costs directly related to fire protection. Although the Plant Board's cost-of-service study included a separate cost component for fire protection, none of these costs were allocated to the wholesale customers.

Under the base-extra capacity methodology, once the various costs have been categorized, allocation factors are used to determine the proportional share of the costs assigned to each customer classification. For example, costs related to meter reading are allocated to each customer classification based on the total number of meters. In the present case, the six public utilities had 11 meters out of a total of 15,744 meters in the Plant Board's system. Accordingly, the wholesale customers are responsible for 0.07 percent of the total meter reading expenses identified by the Plant Board.²⁶

²⁵ For a complete description of the base-extra capacity methodology, see AWWA M1 Manual, *supra* note 23, at 51-57, 71-74.

²⁶ Gannett Fleming Study, *supra* note 2, at 26.

The expenses for water mains were allocated based on Factor 6 in the Gannett Fleming Study.²⁷ This factor is based on the weighting of maximum daily consumption and the maximum hour consumption for each customer classification. In addition, the consumption factors are further weighted by the proportional footage of transmission mains (identified as lines greater than 10 inches in diameter) and distribution mains (identified as lines 10 inches and smaller in diameter). Transmission mains represent approximately 21.3 percent of the Plant Board's water mains; and because maximum daily consumption is most closely related to these larger lines, the maximum daily consumption allocation factor is multiplied by 21.3 percent. Similarly, the maximum hourly consumption is most closely related to the smaller distribution lines, and that consumption allocation factor is multiplied by the remainder, 78.7 percent. The addition of these two products results in the total allocation factor for costs associated with main expenses.

Because Factor 6 of the Gannett Fleming Study is weighted based on the ratio of footage for transmission and distribution mains in the Plant Board's system, the Commission finds that it is not unreasonable to allocate to the wholesale customers the costs associated with mains that are less than 10 inches in diameter and that do not directly serve the wholesale customers.

In addition, there is evidence in the record that water mains smaller than 10 inches in diameter benefit the wholesale customers. Most notably, some of the wholesale customers are directly served through meters connected to lines smaller than

²⁷ *Id.* at 20.

10 inches in diameter.²⁸ In addition, David Billings testified that looped lines (generally 10 inches and smaller in diameter) in the Plant Board's system increase the delivery capabilities, increase the water quality by limiting dead ends, and increase the reliability of service.²⁹

The difference in methodology in the cost-of-service study relied on in the *Pikeville* rate case and the present case provides a clear, distinguishing line between the two cases. The Commission recognizes that it has required expenses for mains smaller than 10 inches in diameter to be eliminated from base-extra capacity method studies.³⁰ The AWWA M1 Manual provides several factors to consider when determining the relative demand factor. It states, "*depending on specific circumstances, the cost analyst may determine that costs for some of the small distribution mains should not be allocated to the wholesale customer.*"³¹ In the present case, Paul Herbert suggested that the Gannett Fleming Study considered the various factors and allocated a portion of the distribution main expenses to the Plant Board's wholesale customers.³² Because specific circumstances are different in this case, the Commission's findings are not inconsistent with prior cases.

²⁸ Plant Board's Response to Commission Staff's Third Set of Information Requests, Item 3, Ex. 5 (filed Feb. 2, 2009); Transcript at 79-80.

²⁹ Transcript at 56-57.

³⁰ See Case No. 2002-00105, *Application of Northern Kentucky Water District for (A) An Adjustment of Rates; (B) A Certificate of Convenience and Necessity for Improvements to Water Facilities If Necessary; and (C) Issuance of Bonds* (Ky. PSC Apr. 30, 2003); Case No. 1994-00056, *Application of Kenton County Water District No. 1: (A) For Authority to Issue Parity Revenue Bonds in the Approximate Principal Amount of \$7,315,000 for the Purpose of Refunding Bond Anticipation Notes and for Other Needs; and (B) Notice of an Adjustment in Water Rates: An Increase of Approximately \$1,834,000 Effective May 1, 1994*, at 15 (Ky. PSC Jan. 24, 1995).

³¹ AWWA M1 Manual, *supra*, note 23, at 235 (emphasis added).

³² Transcript at 121.

2. Storage

The Plant Board has included expenses related to its storage capacity. The Intervenors have argued that they have their own storage to provide adequate service to their customers and, therefore, should not be responsible for any of the expenses related to the Plant Board's storage. This, however, misplaces the focus of determining the proper rate for the Plant Board. The focus should be on the Plant Board's requirements to serve its customers.

Industry standards recommend a storage supply of approximately one average day for water utilities.³³ David Billings testified that, under certain circumstances, it may be appropriate to have storage capacity for two to three times the average daily consumption.³⁴ The Plant Board's average daily consumption is approximately 8 million gallons per day, and it has a storage capacity of approximately 15 million gallons.³⁵ This ratio is reasonable, as it is consistent with industry standards.

In addition, the overhead storage capacity provides additional water pressure to the Plant Board's system, which enables it to provide adequate levels of service to the wholesale customers. Accordingly, a portion of the Plant Board's storage expenses should be allocated to the wholesale customers.

3. Rate Case Expense Allocation

The Plant Board proposes to allocate the total rate case, including the cost-of-service study, to the wholesale customers. It argues that it would not have had to pay

³³ Commission regulations require jurisdictional utilities to have storage capacity equal to the average daily consumption. 807 KAR 5:066, Section 4(4).

³⁴ Transcript at 97.

³⁵ *Id.* at 96.

for the rate case expenses and the cost-of-service study if the Commission did not have jurisdiction over municipal utility rates to public utilities and that it should, therefore, be able to allocate the entire amount of the rate case expenses to the wholesale customers. The Commission agrees that, where a municipal utility has incurred rate proceeding costs to obtain an adjustment in its wholesale rate, those costs directly attributable to the rate case proceeding should be borne by the wholesale customers. For example, the Plant Board would not have accrued \$18,062.48 in expenses for outside counsel if it had not been necessary to litigate this rate case before the Commission. Accordingly, that amount should be allocated entirely to the wholesale customers.

The Commission finds that the cost of the cost-of-service study should be allocated to wholesale and retail customers. The Plant Board increased its retail rates “as a result of this same study” and plans to increase the water service rates to Georgetown based on that study.³⁶ The Commission, therefore, finds that this expense—\$13,107.98—should be allocated to all the customer classifications, as if the Plant Board were a wholly-regulated entity.³⁷ The Plant Board’s expert testified that he would use Factor 18 from the Gannett Fleming Study if these costs were to be spread across all classifications, and we find this to be appropriate.

The Plant Board also proposed to include all rate case costs within its one-year test period. The Commission has generally amortized such costs over a three-to-five-

³⁶ *Id.* at 167. The current rate schedule for the Plant Board mirrors the proposed rates from the cost-of-service study. See Frankfort Electric and Water Plant Board, Current Electric and Water Rates (revised Dec. 8, 2008), available at http://www.fewpb2.com/electric_water_rates_2008.pdf.

³⁷ See Case No. 1998-00283, *Proposed Adjustment of the Wholesale Water Service Rates of the City of Owenton, Kentucky* at 8-10 (Ky. PSC Feb. 22, 1999).

year period based on a utility's history of seeking rate adjustments. The Plant Board increased its rate to wholesale customers in 1999, 2002, and 2005. This proposed increase was to be effective in 2008.³⁸ Although there was testimony that the Plant Board may have another rate case in the near future to recover costs of capital improvements,³⁹ the Commission finds that the Plant Board's prior case history is the most reasonable guide to determining the amortization period and that rate case expenses should be amortized over a three-year period.

SUMMARY

After reviewing the evidence of the record and being otherwise sufficiently advised, the Commission finds that:

1. The estimated rate case expense of \$68,000 should be eliminated from the Plant Board's recoverable expenses.
2. The Plant Board is entitled to recover \$18,062.48 in rate case expenses, 100 percent of which should be allocated to the wholesale customers. This amount should be amortized over a three-year period.
3. The Plant Board is entitled to recover \$13,107.98 for the cost-of-service study, which should be allocated to the wholesale customer based on the study's Factor 18. This amount should be amortized over a three-year period.
4. The capital projects expense of \$1,136,245 should be eliminated from the Plant Board's recoverable expenses.

³⁸ Tariff of Frankfort Electric Plant Board, PSC No. 1, Revised Sheet 2 (effective Jan. 10, 1999); Tariff of Frankfort Electric Plant Board, PSC No. 1, Revised Sheet 3 (effective Apr. 20, 2002); Tariff of Frankfort Electric Plant Board, PSC No. 1, Revised Sheet 3 (effective Mar. 21, 2005).

³⁹ Transcript at 134-35.

5. The Plant Board is entitled to recover a reasonable portion of \$1,079,650 for depreciation expenses.

6. The Plant Board should not allocate any payments in lieu of taxes to the wholesale customers.

7. With the exception of the findings above, the Plant Board's identified expenses are reasonable.

8. With the exception of the findings above, the Plant Board's cost-of-service study's methodology is reasonable.

9. The rate proposed by the Plant Board is unjust and unreasonable and should be denied.

10. A wholesale rate of \$1.704 is fair, just, and reasonable.

11. Because the Plant Board implemented a rate at the end of the statutory suspension period that was higher than approved by this Order, it must refund amounts collected in excess of the rate approved herein.

IT IS THEREFORE ORDERED that:

1. The rate proposed by the Plant Board is denied.

2. The rates set forth in the Appendix to this Order are approved for water service rendered by the Plant Board to its non-water-producing wholesale customers on and after December 8, 2008.

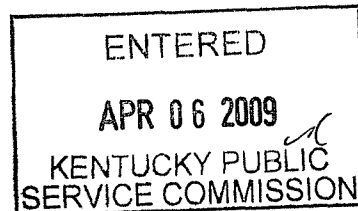
3. Within 20 days of the date of this Order, the Plant Board shall file revised tariff sheets reflecting the rate approved herein.

4. Within 30 days of the date of this Order, the Plant Board shall refund to each of its wholesale purchasers the difference between the amount charged at the

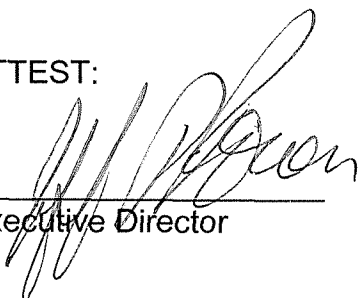
proposed rate for service between December 8, 2008 and the date of this Order and the rate approved herein.

5. Upon receipt of the Plant Board's refund, each of the Intervenors shall immediately apply to the Commission for authority to make adjustments on the amounts charged to its customers' bills, pursuant to 807 KAR 5:068, Section 2(4).

By the Commission



ATTEST:



Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2008-00250 DATED **APR 06 2009**

The following rates and charges are prescribed for the customers in the area served by Frankfort Electric and Water Plant Board. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

Wholesale Water Rate for Non-Producers \$1.704 per 1,000 gallons

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