

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF MONTGOMERY COUNTY)	CASE NO.
WATER DISTRICT NO. 1 FOR RATE ADJUSTMENT)	2009-00343
PURSUANT TO 807 KAR 5:076)	

ORDER

On August 24, 2009, Montgomery County Water District No. 1 ("Montgomery") applied to the Commission for authority to adjust its water rates pursuant to 807 KAR 5:076, the alternative rate filing procedure for small utilities. Because of filing deficiencies, the Commission did not accept the application for filing until September 3, 2009.

Commission Staff, having performed a limited financial review of Montgomery's operations, has prepared the attached report containing its findings and recommendations regarding the proposed rates. All parties should review the report carefully and submit any written comments about Staff's findings and recommendations or requests for a hearing or an informal conference no later than 14 days from the date of this Order.

IT IS THEREFORE ORDERED that:

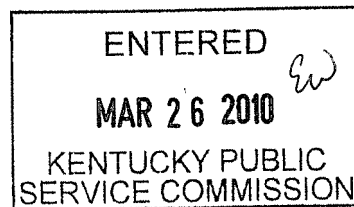
1. All parties shall have 14 days from the date of this Order to submit to the Commission written comments, if any, regarding the attached Staff Report and to request a hearing or an informal conference in this matter.

2. Any party requesting a hearing in this matter shall state in its request its objections to the findings set forth in the Staff Report and provide a brief summary of testimony that it would present at hearing.

3. A party's failure to object to a finding or recommendation contained in the Staff Report within 14 days of the date of this Order shall be deemed as agreement with that finding or recommendation.

4. If no request for a hearing or an informal conference is received within the 14 days, this case shall stand submitted to the Commission for decision.

By the Commission



ATTEST:

Executive Director

STAFF REPORT
ON
MONTGOMERY COUNTY WATER DISTRICT NO. 1
CASE NO. 2009-00343

Montgomery County Water District No. 1 ("Montgomery") applied to the Commission for authority to adjust its water rates pursuant to 807 KAR 5:076, the alternative rate filing procedure for small utilities.

In order to evaluate the requested increase, Commission Staff performed a limited financial review of Montgomery's test period operations for the calendar year ending December 31, 2008. 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.

Mark Frost and Sam Reid of the Commission's Division of Financial Analysis performed the limited review. This report summarizes Staff's review and recommendations. Mr. Reid is responsible for the pro forma revenue adjustment and the rate determination. Mr. Frost is responsible for all pro forma expense adjustments and the revenue requirement determination.

The comparison of Montgomery's actual and pro forma operations is attached hereto as Appendix A. Based upon the recommendations and findings of Staff's limited review of the operating revenues and expenses reported in the 2008 Annual Report and Montgomery's responses to Staff's Information Requests, Montgomery's pro forma

operating statement appears as set forth in Appendix B. The discussions of Staff's proposed pro forma adjustments are shown in Appendix C.

In its revenue requirement calculation, Montgomery included principal and interest payments of \$12,000 and \$13,000, respectively.¹ The only outstanding long-term indebtedness that Montgomery reports in its 2008 Annual Report is the 1983 Revenue Bonds. Using a 3-year average of principal and interest payments for the calendar years 2010 through 2012, Staff calculates a debt service for long-term debt of \$25,225 as shown in Table 1 below.

Table 1: Debt Service - 3 Year Average			
Year	Principal Due	Interest Due	Principal & Interest
2010	\$ 14,000	\$ 11,600	\$ 25,600
2011	14,000	10,900	24,900
2012	15,000	10,175	25,175
	<u>\$ 43,000</u>	<u>\$ 32,675</u>	<u>\$ 75,675</u>
	\$ 14,333	\$ 10,892	\$ 25,225

In its application, Montgomery states that it is requesting an increase in rates that will produce additional operating revenues from water sales of \$290,204.² However, by applying Montgomery's requested rates to its billing analysis, Staff determined that Montgomery is actually requesting a revenue requirement from rates of \$296,764, an increase of \$70,227 or 31 percent over the normalized revenue from rates of \$226,537.³

¹ Application at 2.

² Id. \$25,200 (Annual Debt Service) + \$5,040 (Requested Coverage) + \$231,002 (Pro Forma Operating Expenses) + \$37,936 (75% of Depreciation Expense) - \$8,974 (Other Operating Revenues) = \$290,204.

³ Id. Billing Analysis - 75% Depreciation Funded.

As shown in Table 2 below, Staff's recommended pro forma operating expense, annual debt service of \$25,225, a 1.2x DSC, and inclusion of 100 percent of Montgomery's depreciation expense, results in a revenue requirement from rates of \$301,111, an increase of \$74,574 or 32.919 percent over Staff's normalized revenue from rates of \$226,537.

Table 2: Revenue Requirement	
	Requirement
Debt Service Coverage - KRWA Bonds	\$ 25,225
Debt Service Coverage - RD Bonds	x 1.20
Required Debt Service & Coverage	\$ 30,270
Add: Pro Forma Operating Expenses	219,142
Depreciation and Amortization	51,308
Taxes Other Than Income	+ 12,416
Total Revenue Requirement	\$ 313,136
Less: Other Income & Deductions	- 3,051
Revenue Requirement from Operations	\$ 310,085
Less: Other Operating Revenues	- 8,974
Revenue Requirement from Water Sales	\$ 301,111
Less: Pro Forma Revenue - Water Sales	- 226,537
Staff's Recommended Increase	\$ 74,574
Percentage Increase	32.919%

Staff finds that Montgomery's requested revenue requirement will produce a positive cash flow of \$52,006,⁴ is sufficient for it to pay the pro forma "cash" expenses, and to provide for future equity growth. Therefore, Staff recommends the Commission

⁴ Revenue Requirement - Water Sales	\$ 296,764
Add: Other Operating Revenues	8,974
Other Income and Deductions	+ 3,051
Total Requested Revenue	\$ 308,789
Less: Staff's Pro Forma Operating Expenses	- 282,866
Net Operating Income	\$ 25,923
Add: Depreciation & Amortization	+ 51,308
Subtotal	\$ 77,231
Less: Debt Service	- 25,225
Net Cash Flow	\$ 52,006


allow Montgomery to increase its water rates to a level that will generate the requested revenue requirement of \$296,764. Should Montgomery decide to further increase rates to generate the \$301,111 revenue requirement as determined by Staff, it should amend its application to request that level of revenue and shall provide confirmation to the Commission that it has published notice of those rates pursuant to 807 KAR 5:011, Section 8.

Staff recommends that the Commission approve the rates that were requested by Montgomery and that are set forth in Appendix C. If Montgomery amends its application, then it should amend its application to reflect the rates contained in Appendix D as they will produce the revenue requirement Staff determined Montgomery could justify of \$301,111.

Signatures



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



Prepared by: Sam Reid
Manager, Communications, Water and
Sewer Rate Design Branch
Division of Financial Analysis

APPENDIX A
 STAFF REPORT CASE NO. 2009-00343
 MONTGOMERY'S REQUESTED
 PRO FORMA INCOME STATEMENT

	<u>Test-Period Operations</u>	<u>Pro Forma Adjustments</u>	<u>Pro Forma Operations</u>
Operating Revenues:			
Revenues - Sales of Water	\$ 232,114	\$ 0	\$ 232,114
Other Operating Revenues	8,974	0	8,974
Total Operating Revenues	<u>\$ 241,088</u>	<u>\$ 0</u>	<u>\$ 241,088</u>
Operating Expenses:			
Operation & Maintenance:			
Salaries & Wages - Emp.	\$ 62,824	\$ 0	\$ 62,824
Salaries & Wages - Officers	5,400	0	5,400
Emp. Pension & Benefits	15,565	0	15,565
Purchased Water	86,465	0	86,465
Purchased Power	0	1,409	1,409
Materials & Supplies	11,279	0	11,279
Cont. Services - Accounting	5,680	0	5,680
Cont. Services - Water Testing	3,625	1,799	5,424
Cont. Services - Other	19,796	0	19,796
Rental Bld/Real Property	3,762	0	3,762
Transportation	215	0	215
Ins. - Vehicle	0	0	0
Ins. - Gen. Liability	5,430	0	5,430
Ins. - Worker's Comp.	1,500	0	1,500
Advertising	1,069	0	1,069
Miscellaneous	5,184	0	5,184
Total Operation & Maint.	<u>\$ 227,794</u>	<u>\$ 3,208</u>	<u>\$ 231,002</u>
Depreciation	50,581	(12,645)	37,936
Taxes Other Than Income ¹	13,249	0	13,249
Utility Operating Expenses	<u>\$ 291,624</u>	<u>\$ (22,686)</u>	<u>\$ 268,938</u>
Net Utility Operating Income	<u>\$ (50,536)</u>	<u>\$ 22,686</u>	<u>\$ (27,850)</u>
Other Income & Deductions:			
Interest Income ²	3,051	(3,051)	0
Net Inc. Available for Debt Service	<u>\$ (47,485)</u>	<u>\$ 19,635</u>	<u>\$ (27,850)</u>

¹ Montgomery did not include taxes other than income taxes in its pro forma income statement.

² Montgomery did not include interest income in its pro forma income statement.

APPENDIX B
STAFF REPORT CASE NO. 2009-00343
STAFF'S RECOMMENDED
PRO FORMA INCOME STATEMENT

	<u>Test-Period Operations</u>	<u>Pro Forma Adjustments</u>	Adj. Ref	<u>Pro Forma Operations</u>
Operating Revenues:				
Revenues - Sales of Water	\$ 232,114	\$ (5,577)	(a)	\$ 226,537
Other Operating Revenues	8,974	0		8,974
Total Operating Revenues	<u>\$ 241,088</u>	<u>\$ (5,577)</u>		<u>\$ 235,511</u>
Operating Expenses:				
Operation & Maintenance:				
Salaries & Wages - Emp.	\$ 62,824	\$ 2,320	(b)	\$ 65,144
Salaries & Wages - Officers	5,400	0		5,400
Employee Pension & Benefits	15,565	662	(c)	16,227
Purchased Water	86,465	0		86,465
Purchased Power	0	2,510	(d)	2,510
Materials & Supplies	11,279	(7,527)	(e)	3,752
Cont. Services - Accounting	5,680	0		5,680
Cont. Services - Water Testing	3,625	(1,000)	(f)	2,625
Cont. Services - Other	19,796	(5,090)	(g)	14,706
Rental Bld/Real Property	3,762	0		3,762
Transportation	215	0		215
Ins. - Gen. Liability	5,430	(55)	(h)	5,375
Ins. - Worker's Comp.	1,500	(174)	(i)	1,326
Advertising	1,069	0		1,069
Miscellaneous	5,184	(298)	(d)	4,886
Total Operation & Maint.	<u>\$ 227,794</u>	<u>\$ (8,652)</u>		<u>\$ 219,142</u>
Depreciation	50,581	327	(j)	50,908
Amortization	0	400	(k)	400
Taxes Other Than Income	13,249	(833)		12,416
Utility Operating Exp.	<u>\$ 291,624</u>	<u>\$ (8,758)</u>		<u>\$ 282,866</u>
Net Utility Operating Income	<u>\$ (50,536)</u>	<u>\$ 3,181</u>		<u>\$ (47,355)</u>
Other Income & Deductions:				
Interest Income	3,051	0		3,051
Net Inc. Available for Debt Service	<u><u>\$ (47,485)</u></u>	<u><u>\$ 3,181</u></u>		<u><u>\$ (44,304)</u></u>

APPENDIX C
 STAFF REPORT CASE NO. 2009-00343
 STAFF'S PRO FORMA ADJUSTMENTS

a. Metered Water Sales. In its 2008 Annual Report, Montgomery reported test-period revenue from metered water sales of \$232,114. Applying the current tariffed rates to the test-period billing information, Montgomery prepared a billing analysis, which results in a reduction of \$5,577 or 2.41 percent to the reported test-period revenues from metered water sales. In reviewing Montgomery's proposed billing analysis, Staff believes that it produces a normalized revenue that is within a range of reasonableness and, therefore, recommends that the Commission reduce revenue from metered water sales by \$5,577 to a normalized level of \$226,537.

b. Salaries and Wages - Employees. Montgomery reports a test-period level of salaries and wages - employees expense of \$62,824. Using Montgomery's current staff level and the hourly wages currently in effect, Staff calculates a pro forma salaries and wages expense of \$65,144, as shown in the Table 4 below. Accordingly, Staff recommends salaries and wages expense - employees be increased by \$2,320 to reflect its pro forma level of \$65,144.

Table 4: Pro Forma Salaries and Wages - Emp.				
Title	Current Pay Rate	Type	2008 Hrs Regular	Pro Forma Payroll
Office Clerk	\$ 8.00	Hourly	268	\$ 2,144
Office Manager	\$ 12.50	Hourly	2,080	26,000
Serviceman	\$ 600.00	Bi-Weekly	N/A	15,600
Ops Mgr.	\$ 21,400.00	Salary	N/A	21,400
Total				\$ 65,144

c. Employee Pensions and Benefits. Montgomery reports a test-period level of employee pensions and benefits expense of \$15,565. On July 1, 2009, the County Employees Retirement System employer contribution rate was increased to 16.16 percent. Using the current employee health insurance premiums and the employer

retirement contribution rate of 16.16 percent, Staff calculates a pro forma level of employee pensions and benefits expense of \$16,227. Staff recommends that Montgomery's employee pensions and benefits expense be increased by \$662 to reflect Staff's pro forma level.

d. Purchased Power. Montgomery proposes to increase test-period operating expense by \$1,409 to reflect its pro forma purchased power expense. Montgomery claims that its system consists of 2 separate pressure zones.¹ According to Montgomery the first zone receives its water from the Mt. Sterling Water and Sewer System and the second zone receives water from an elevated storage tank.² Because the water pressure at the storage tank is less than the pressure from Mt. Sterling, Montgomery installed a booster pump at the storage tank.³ Montgomery states that its pro forma adjustment reflects the estimated electric expense that will be incurred to operate the booster pump.

In reviewing the general ledger and invoices, Staff determined that Montgomery incorrectly recorded its test period electric expense of \$298 in the miscellaneous expense account and that \$143 of this amount was incurred at the elevated storage tank site. Further, the Kentucky Utilities invoices for the calendar year 2009 for the power supplied at the elevated storage tank is \$2,355, which is \$946 greater than the amount estimated by Montgomery.

¹ Montgomery's response to the Commission Staff's Initial Information Request, Item 6.

² Id.

³ Id.

It is Staff's belief that an adjustment to reflect the cost of electricity at the elevated storage tank meets the rate-making criteria of being known and measurable. For this reason Staff is reducing miscellaneous expense by \$298 to correct the misclassified electricity expense and is increasing operating expenses by \$2,510⁴ to reflect the on-going cost of electricity.

e. Materials and Supplies. Montgomery reports a test-period level of materials and supplies expense of \$11,279. In reviewing the test-period invoices, Staff discovered that \$7,527 of capital expenditures were incorrectly recorded by Montgomery as an expense. To eliminate the capital expenditures that are listed in Table 5 below, Staff is proposing to reduce Montgomery's materials and supplies expense by \$6,766.

Date	Vendor	Description	Amount
03/03/08	Water Works Supplies	Auto. Flushing Devices	\$ 5,940
06/06/08	Consolidated Pipe Co.	Meter Set Parts	1,450
06/06/08	Consolidated Pipe Co.	Meter reading Scope	137
Total			\$ 7,527

f. Contractual Services - Water Testing. Montgomery proposes to increase its test-period contractual service - water testing expense of \$3,625 by \$1,799 to reflect the cost of a new testing requirement. According to Montgomery, the Division of Water is now requiring it to perform the "2 H5 and THM" tests two times in 2008 and again two time in 2009.⁵

⁴ \$155 (KU Account # 645927) + \$2,355 (2009 Electric Expense KU Account # 647954-0010 and 3000-06689867) = \$2,510.

⁵ Montgomery's response to the Commission Staff's Second Information Request, Item 5(a).

A review of the invoices provided by Montgomery, shows that in 2008 Montgomery paid Icrobac Laboratories, Inc. approximately \$1,000 for performing the two “2 H5 and THM” tests.⁶ According to the “IDSE Standard Monitoring Factsheet” supplied by Montgomery, the actual compliance monitoring will not begin until the calendar year 2012, which is 5 years from the year the initial tests were required.

An adjustment to reflect the cost to comply with the Division of Water “2 H5 and THM” testing requirement would meet the rate-making criteria of being known and measurable. However, given that the monitoring will not be required until 2012, Staff is recommending that the costs incurred in 2008 and 2009 be amortized over five years. Accordingly, Staff is reducing contractual expenses - water testing by \$1,000 to remove the cost to the “2 H5 and THM” tests and increasing operating expenses by \$400 to reflect amortizing the cost of the “2 H5 and THM” over five years.

g. Contractual Services - Other. Montgomery reports a test-period level of contractual services - other expense of \$19,796. In reviewing the test-period invoices, Staff discovered that \$5,090 of the reported test-period expenses were for labor costs associated with capital projects. To eliminate the capital expenditures that are listed in Table 6 below, Staff is proposing to reduce Montgomery’s materials and supplies expense by \$5,950.

Table 6: Capital Labor Expenditures		
Vendor	Description	Amount
Keath Construction & Plumbing	Install Auto Blow Off	\$ 2,200
Keath Construction & Plumbing	Set Meter	2,890
		<u>\$ 5,090</u>

⁶ Montgomery’s response to the Commission Staff’s Initial Information Request, Exhibit 8.

h. Insurance - General Liability. Montgomery reports a test-period level of insurance - general liability expense of \$5,430. The general liability insurance premiums for the 12 month period of 2009 through 2010 are \$5,375, which is \$55 less than the reported expense. Accordingly, Staff is reducing test-period insurance - general liability expense by \$55.

i. Insurance - General Liability. Montgomery reports a test-period level of insurance - workers' compensation expense of \$1,500. The workers' compensation insurance premiums for the 12 month period of 2009 through 2010 are \$1,326, which is \$174 less than the reported expense. Accordingly, Staff is reducing test-period insurance - workers' compensation expense by \$174.

j. Depreciation. Montgomery reports a test-period level of depreciation expense of \$50,851. As shown in Table 6 below, Staff calculates a pro forma depreciation adjustment of \$327 to reflect depreciating the capital expenditures removed from operating expenses over their estimated useful lives.

	Cost	Useful Life	Annual Depreciation
Set Meter	\$ 2,890	40	\$ 72
Install Auto Blow Off	\$ 1,100	40	28
Install Auto Blow Off	\$ 1,100	40	28
Eclipse Auto. Flushing Devises	\$ 5,940	40	149
Meter Set Parts	\$ 1,450	40	36
Meter reading Scope	\$ 137	10	14
Total			\$ 327

k. Payroll Taxes. Montgomery did not include this expense in its pro forma income statement, it did report a test period payroll tax expense of \$6,262 in the 2008

Annual Report.⁷ Using the pro forma payroll determined reasonable herein and the current "FICA" rate of 7.65 percent, Staff calculates a pro forma payroll tax expense of \$5,429, a decrease of \$833 below the reported level. Accordingly, Staff proposes to decrease payroll tax expense by \$833.

⁷ Annual Report of Montgomery to the Public Service Commission of the Commonwealth of Kentucky for the Calendar Year Ended December 31, 2008 ("2008 Annual Report") at 25.

APPENDIX D
STAFF REPORT CASE NO. 2009-00343
REQUESTED RATES AND CHARGES

RATES AND CHARGES

<u>RATE CLASSIFICATION</u>			<u>Rates</u>	
First	2,000	Gallons	\$	20.62 Minimum Bill
Next	3,000	Gallons	\$	6.22 per 1,000 Gallons
Next	5,000	Gallons	\$	5.52 per 1,000 Gallons
Over	10,000	Gallons	\$	4.81 per 1,000 Gallons

APPENDIX E
STAFF REPORT CASE NO. 2009-00343
RATES AND CHARGES
MONTGOMERY COULD JUSTIFY

RATES AND CHARGES

<u>RATE CLASSIFICATION</u>			<u>Rates</u>	
First	2,000	Gallons	\$ 20.93	Minimum Bill
Next	3,000	Gallons	\$ 6.32	per 1,000 Gallons
Next	5,000	Gallons	\$ 5.60	per 1,000 Gallons
Over	10,000	Gallons	\$ 4.88	per 1,000 Gallons

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