

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF HICKORY WATER	)	
DISTRICT FOR APPROVAL OF INCREASED	)	CASE NO. 2009-00350
RATES FOR WATER SERVICE	)	

ORDER

On August 28, 2009, Hickory Water District ("Hickory") 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.

Commission Staff, having performed a limited financial review of Hickory'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.

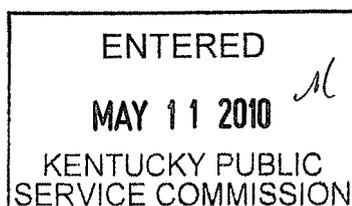
IT IS THEREFORE ORDERED that:

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 shall provide a brief summary of testimony that it would present at hearing.

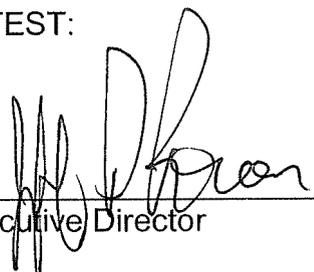
3. A party's failure to object to a finding or recommendation contained in the Staff Report within 14 days of the date of this Order shall be deemed as agreement with that finding or recommendation.

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  
HICKORY WATER DISTRICT  
CASE NO. 2009-00350

On August 28, 2009, Hickory Water District ("Hickory") filed an application requesting authority to increase its rates for water service pursuant to 807 KAR 5:076. The application was based on the test year ended December 31, 2008. At the end of the test year, Hickory served approximately 1,332 customers. In its application, Hickory proposed to increase its rates by 20 percent, although they justified an increase of 31.27 percent. The evidence provided in Hickory's application demonstrates that the proposed rates will produce \$385,644 in annual revenue, an increase of \$65,610 over normalized test-year water revenue of \$320,034. Hickory's proposed rates would increase a customer's monthly bill by 20 percent.

Commission Staff ("Staff") performed a limited financial review of Hickory's test-year operations to determine the reasonableness of Hickory's requested rates. The scope of Staff's review was limited to obtaining information as to whether the test-year operating revenues and expenses were representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

This report summarizes Staff's findings and recommendations resulting from its review of Hickory's test-period operations. Daryl Parks is responsible for all portions of this report related to revenue requirements and Eddie Beavers is responsible for normalized revenues and rate design.

Appendix A to this report provides a detailed calculation of Hickory's revenue requirement as determined by Staff. As shown in Appendix B, Staff calculated Hickory's revenue requirement from rates to be \$533,014, requiring an increase of \$212,980, or 66.55 percent, over test-year revenues from rates of \$320,034. A major portion of the increase as calculated by Staff is due to the contract between Hickory and Mayfield Electric and Water for the provision of Hickory's operational and maintenance needs.

Although the financial information presented by Staff in this report indicates that Hickory could justify rates in excess of those requested in its application, Staff recommends that the Commission approve the rates requested by Hickory.

Signatures:



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Prepared by: Daryl Parks  
Public Utilities Financial Analyst III  
Financial Audit Branch  
Division of Financial Analysis



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

APPENDIX A  
STAFF REPORT, CASE NO. 2009-00350  
STAFF'S ADJUSTED OPERATIONS

	Test Year	Adjustment	Ref.	Pro forma
<b>Operating Revenues</b>				
Total Sales of Water	\$ 317,925	\$ 2,109	A	\$ 320,034
Other Water Revenue	<u>8,017</u>	<u>0</u>		<u>8,017</u>
<b>Total Operating Revenues</b>	<b>\$ 325,942</b>	<b>\$ 2,109</b>		<b>\$ 328,051</b>
<b>Operating Expenses</b>				
Operation and Maintenance Expenses				
Purchased Water	10,475	4,503	B	14,978
Purchased Power	31,862	3,833	C	35,695
Chemicals	38,101			38,101
Materials and Supplies	26,140			26,140
Contractual Services - Eng.	300			300
Contractual Services - Acct.	7,440			7,440
Contractual Services - Mgmt Fees	22,608	212,064	D	234,672
Contractual Services - Water Testing	17,633	(13,586)	E	4,047
Contractual Services - Other	91,965	(90,755)	F	1,210
Rental Equipment	118	11,507	G	11,625
Insurance - General Liability	5,740	697	H	6,437
Advertising Expenses	336			336
Bad Debt	874			874
Miscellaneous Expenses	<u>5,810</u>	<u>(406)</u>	I	<u>5,404</u>
<b>Total Operation and Maintenance Expenses</b>	<b>\$ 259,402</b>	<b>\$ 127,857</b>		<b>\$ 387,259</b>
Depreciation	92,766	15,406	J	108,172
Amortization	0	667	K	667
Taxes Other than Income	<u>40</u>	<u>0</u>		<u>40</u>
<b>Total Operating Expenses</b>	<b>\$ 352,208</b>	<b>\$ 143,930</b>		<b>\$ 496,138</b>
<b>Utility Operating Income</b>	<b>(26,266)</b>	<b>(141,821)</b>		<b>(168,087)</b>
Plus: Interest and Dividend Income	<u>9,964</u>	<u>(7,972)</u>	L	<u>1,992</u>
<b>Income Available to Service Debt</b>	<b>\$ (16,302)</b>	<b>\$ (149,793)</b>		<b>\$ (166,095)</b>

(A) Water Sales. During the test year, Hickory reported total metered water sales of \$317,925. The current tariff rates applied to the test-year billing information results in an increase of \$2,109, or 0.66 percent, to the reported test-year revenue from metered water sales. Staff has accepted this adjustment.

(B) Purchased Water. For the 2008 test year, Hickory reported \$10,475 in expenses for purchased water. According to Hickory's 2009 general ledger, this amount increased to \$14,978. Therefore, Staff increased the pro forma amount of the purchased water by \$4,503.

(C) Purchased Power. For the 2008 test year, Hickory reported \$31,862 in expenses for purchased power. According to Hickory's 2009 general ledger, this amount increased to \$35,695. Therefore, Staff increased the pro forma amount of the purchased power by \$3,833.

(D) Contractual Services – Mgmt Fees. For the 2008 test year, the Contractual Services - Mgmt Fees account consisted of payments to Bill Sears, Kevin Leonard, Nancy Jones, Sam Davis and one payment to United Systems. For 2009, the salary for Bill Sears and Kevin Leonard remained the same, while the amount of compensation to Sam Davis decreased by \$37, from \$2,545 to \$2,508. Nancy Jones's salary is being reduced by \$12,160, from \$14,560 to \$2,400. During 2009, Hickory ended its contractual arrangement with Ms. Jones and, in September of 2009, began paying her a salary of \$200 per month. Therefore, her pro forma salary is \$2,400 per year.

One payment in this account was made to United Systems. This payment should have been included with the other payments to United Systems and placed in the account Contractual Services – Other.

During 2009, Hickory contracted with Mayfield Electric and Water (“Mayfield”) to manage the operational and maintenance needs of Hickory. Six months of payments to Mayfield were recorded in 2009 operations. To annualize the contractual payments to Mayfield for 2009, Staff multiplied the total for these six months by two to obtain the test-period pro forma expense.

Six Months of payments to Mayfield in 2009 for Management Fees	\$112,482
Multiplied by two to annualize the payments	x 2
Pro Forma amount of payments to Mayfield	<u>\$224,964</u>

<u>Contractor</u>	<u>Test Year Expense</u>	<u>Pro Forma Amount</u>	<u>Difference</u>
Bill Sears	\$ 2,400	\$ 2,400	\$ 0
Kevin Leonard	2,400	2,400	0
Nancy Jones	14,560	2,400	(12,160)
Sam Davis	2,545	2,508	(37)
City of Mayfield	0	224,964	224,964
Transfer of United System expenses to Acct 636	<u>703</u>	<u>0</u>	<u>(703)</u>
<b>Pro Forma adjustment to Management Fees</b>	<b>\$ 22,608</b>	<b>\$ 234,672</b>	<b>\$ 212,064</b>

(E) Contractual Services – Water Testing. In response to Staff’s second data request, Item 3, Hickory stated that it had terminated its contractual agreement with Rex Beckham. The \$14,928 paid to Mr. Beckham during the test year has been removed from the pro forma expenses. During the test year, \$2,519 was paid to McCoy & McCoy. During 2009, the amount paid was \$3,861, an increase of \$1,342. Therefore, a reduction of \$13,586 was made to the pro forma statement.

(F) Contractual Services - Other. In 2009, Hickory terminated its contractual agreement with Dale Burnett, and the general ledger shows Hickory began paying him a salary of \$200 per month. In addition to the pro forma adjustment for Mr. Burnett, the following were adjusted to reflect their 2009 expense levels:

	<u>Test Year Expense</u>	<u>Pro Forma Amount</u>	<u>Difference</u>
Dale Burnett	\$ 82,938	\$ 2,400	\$ (80,538)
United Systems	11,571	4,844	(6,727)
Sidener Environmental	1,422	0	(1,422)
CWI	111	337	226
Regal Answering	1,073	454	(619)
Telephone Answering	0	249	249
D & K	195	0	(195)
KIA	741	352	(389)
K & E Real Estate	690	0	(690)
PADD	375	0	(375)
Mayfield Printing	275	0	(275)
<b>Pro Forma adjustment for Contractual Services - Other</b>			<b>\$ (90,755)</b>

(G) Rental Equipment. Rental Equipment expenses for the test year totaled \$118. The rental expenses listed on the general ledger for 2009 were to Mayfield. These expenses were for renting vehicles, a backhoe, and a boring machine from Mayfield. One monthly entry was made for each of the last four months of 2009 totaling \$3,875. As these payments were made during the last four months of calendar year 2009, the total expense will be annualized by multiplying this amount by three to derive the pro forma expense adjustment.

Total Rental expense for last 4 months of 2009	\$ 3,875
Multiplied by 3 to annualize	<u>x 3</u>
Adjusted rental expenses for 2009	11,625
Rental expenses for the test year	<u>(118)</u>
Pro Forma adjustment to Rental Equipment	\$ 11,507

(H) Insurance – General Liability. Hickory currently has insurance coverage through CNA Surety and The Cincinnati Insurance Company. Hickory's current policy with The Cincinnati Insurance Company is for general liability and the current cost is \$6,011 for one year of coverage. Hickory's current policy with CNA Surety is for bond insurance and the current cost is \$223 a year for their KY PEHBP #2 Bond and \$203 for the KY Highway Encroachment Bond. The total pro forma expense for these insurance policies is \$6,437 and the cost of the insurance policies for the test year was \$5,740. This requires an increase of \$697 to the pro forma expenses.

(I) Miscellaneous Expenses. For the test year, two expenses were excluded. The first did not relate to the utility's provision of water service--check #11758 for \$106 to Awardmasters--and the second was a double entry--check #12077 for \$300 to Wilson Ornamental Iron. When asked for clarification for the two entries, Hickory supplied one invoice in response to the second data request. As Hickory failed to adequately justify these expenditures, they have been excluded from its pro forma operations and a reduction of \$406 was made to Miscellaneous Expenses.

(J) Depreciation. Test-year depreciation has been increased by \$15,406 to reflect the service lives recommended by the National Association of Regulatory Utility Commissioners (NARUC) using the straight line remaining life method and a list of the assets whose useful lives were adjusted is in Appendix D. This change in accounting estimate should be accounted for in Hickory's financial statements going forward. A copy of the NARUC-recommended life ranges has been included as Appendix E.

The depreciation total listed in the test year has been reduced by \$260 from \$93,026 to \$92,766 due to the total amount of depreciation shown on the depreciation schedule provided by Hickory.

Hickory stated in its application that it wanted to decrease the useful lives of the assets in Account 334, Meters and Meter Installations, from 40 to 10 years. Staff recommends that the useful life be kept at 40 years. Hickory was unable to separate the cost of the meters from the meter installations, which normally have a service life of 40 years or more. Second, the cost of the meter in comparison to the cost of installation is very small. In response to the Staff Data Request, Item 4, Hickory's response is that "the PSC suggests that meters should be replaced on a 10-year cycle." Commission regulations state that 5/8" or 5/8" x 3/4" meters should be tested every 10 years.<sup>1</sup> Hickory did not provide a cost-benefit analysis that showed replacing the meters every 10 years would be more cost-efficient than having the meters tested. Given the above, Staff sees no reason to adjust the useful lives of the assets located in Account 334.

(K) Amortization. Hickory states in their application that they wish to amortize the rate case expense over three years. Staff agrees with this adjustment.

(L) Interest and Dividend Income. Hickory states in their application that they wish to exclude \$7,972 in interest income attributed to restricted cash investments. Staff agrees with this adjustment.

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<sup>1</sup> 807 KAR 5:066, Section 16(1).

APPENDIX B  
STAFF REPORT, CASE NO. 2009-00350  
CALCULATION OF REVENUE REQUIREMENT

Pro forma Operating Expense	\$ 496,138
Debt Service Subject to Coverage Requirements	39,071
Debt Service Coverage at 120%	<u>7,814</u>
<b>Total Revenue Requirement</b>	<b>\$ 543,023</b>
Less:	
Other Operating Revenue	8,017
Interest and Dividend Income	<u>1,992</u>
<b>Revenue Required from Rates</b>	<b>\$ 533,014</b>
Less:	
Pro forma Present Rate Water Sales	<u>320,034</u>
<b>Revenue Deficiency</b>	<b>\$ 212,980</b>
Percentage to Present Rate Revenues	66.55%

APPENDIX C  
STAFF REPORT, CASE NO. 2009-00350  
STAFF'S RECOMMENDED WATER RATES

MONTHLY WATER RATES

3/4" Meter

First	2,000	gallons	\$ 10.26	Minimum bill
Next	3,000	gallons	3.48	per 1,000 gallons
Next	5,000	gallons	3.24	per 1,000 gallons
Next	10,000	gallons	3.00	per 1,000 gallons
Next	30,000	gallons	2.16	per 1,000 gallons
Next	50,000	gallons	1.80	per 1,000 gallons
All Over	100,000	gallons	1.50	per 1,000 gallons

1" Meter

First	6,000	gallons	\$ 23.94	Minimum bill
Next	4,000	gallons	3.24	per 1,000 gallons
Next	10,000	gallons	3.00	per 1,000 gallons
Next	30,000	gallons	2.16	per 1,000 gallons
Next	50,000	gallons	1.80	per 1,000 gallons
All Over	100,000	gallons	1.50	per 1,000 gallons

1 1/2" Meter

First	7,500	gallons	\$ 28.80	Minimum bill
Next	2,500	gallons	3.24	per 1,000 gallons
Next	10,000	gallons	3.00	per 1,000 gallons
Next	30,000	gallons	2.16	per 1,000 gallons
Next	50,000	gallons	1.80	per 1,000 gallons
All Over	100,000	gallons	1.50	per 1,000 gallons

2" Meter

First	15,000	gallons	\$ 51.90	Minimum bill
Next	5,000	gallons	3.00	per 1,000 gallons
Next	30,000	gallons	2.16	per 1,000 gallons
Next	50,000	gallons	1.80	per 1,000 gallons
All Over	100,000	gallons	1.50	per 1,000 gallons

3" and 4" Meters

First	100,000	gallons	\$ 221.70	Minimum bill
All Over	100,000	gallons	1.50	per 1,000 gallons

APPENDIX D  
STAFF REPORT, CASE NO. 2009-00350  
DEPRECIATION SCHEDULE ADJUSTMENTS

	<u>Date</u>	<u>Left to be Depreciated as of 12/31/09</u>	<u>New Life</u>	<u>New Dep Expense</u>
<b>304 - Structures &amp; Improvements</b>				
Water Treatment Plant	11/94	\$ 23,989	35	\$ 1,106
Water Treatment Plant - addtl	1/95-5/95	3,626	35	167
New Roof - Office Bldg	3/6/97	404	35	16
Engineering	1/10/97	2,788	35	111
Garage Door	1/1/07	788	35	23
<b>307 Wells &amp; Springs</b>				
Repair - West Well	10/94	\$ 3,511	35	\$ 147
Repair - Well #3	12/30/97	4,500	35	174
Repair - Well #3	1/9/98	1,550	35	60
Cleaning of Well #3 - reclass from Water Trmt Equip	12/30/97	1,299	35	50
Repair/Maintenance - Well #3	1/1/99	1,738	35	66
Pump/West Well repair	2/21/00	10,014	35	362
Replace motor in well	6/02/02	958	35	32
<b>330 Distribution Reservoirs (Tanks)</b>				
Water Tank - Industrial Park	9/1/01	\$ 670,549	30	\$ 40,188
New Transducer on Tank in Lowes	8/6/02	1,043	35	35
<b>339 Other Plant &amp; Miscellaneous Equipment</b>				
Radio Equipment	12/31/04	\$ 12,309	10	\$ 308
Radio Equipment	8/7/07	4,252	10	530
<b>340 Furniture/Fixtures</b>				
A/C unit for Office	10/3/02	\$ 569	20	\$ 32
Software for new billing system	1/1/08	5,125	20	253
Copier	12/31/08	795	20	38

APPENDIX E  
STAFF REPORT, CASE NO. 2009-00350  
NARUC-RECOMMENDED LIFE RANGES

FIGURE 1

Typical Average Service Lives,  
Salvage Rates, and Depreciation Rates

Small Water Utilities

NARUC Account Number	Class of Plant	Average Service Life Years	Net Salvage Percent	Depreciati Rate Percent
<u>Source of Supply Plant</u>				
311	Structures and Improvements	35-40		2.9-2.5
312	Collecting & Impounding Reservoirs	50-75		2.0-1.3
313	Lake, River and Other Intakes	35-45		2.9-2.2
314	Wells and Springs	25-35		4.0-2.9
315	Galleries and Tunnels	25-50		4.0-2.0
316	Supply Mains	50-75		2.0-1.3
317	Other Source of Water-Supply Plant	30-40		3.3-2.5
<u>Pumping Plant</u>				
321	Structures and Improvements	35-40		2.9-2.5
324-7	Pumping Equipment	20		5.0
322	Other Pumping Plant	25		4.0
<u>Water Treatment Plant</u>				
331	Structures and Improvements	35-40		2.9-2.5
332	Water Treatment Equipment	20-35		5.0-2.9
<u>Transmission and Distribution Plant</u>				
341	Structures and Improvements	35-40		2.9-2.5
342	Reservoirs and Tanks	30-60		3.3-1.7
343	Transmission and Distribution Mains	50-75		2.0-1.3
344	Fire Mains	50-75		2.0-1.3
345	Services	30-50		3.3-2.0
346	Meters	35-45	10	2.6-2.0
347	Meter Installations	40-50		2.5-2.0
348	Hydrants	40-60	5	2.4-1.6
<u>General Plant</u>				
390	Structures & Improvements	35-40		2.9-2.5
391	Office Furniture and Equipment	20-25	5	4.8-3.8
392	Transportation Equipment	7	10	12.9
393	Stores Equipment	20		5.0
	Tools, Shop & Garage Equipment	15-20	5	6.3-4.8
	Laboratory Equipment	15-20		6.7-5.0
396	Power Operated Equipment	10-15	10	9.0-6.0
397	Communication Equipment	10	10	9.0

Sam Davis  
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