

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF HENRY COUNTY WATER)	
DISTRICT NO. 2 FOR APPROVAL TO ADJUST)	
WATER RATES AND CHARGES AND TO)	CASE NO. 2009-00370
IMPLEMENT A SYSTEM DEVELOPMENT)	
CHARGE)	

COMMISSION STAFF'S SECOND SET OF INFORMATION
REQUESTS TO HENRY COUNTY WATER DISTRICT NO. 2

Henry County Water District No. 2 ("Henry District"), pursuant to 807 KAR 5:001, shall file with the Commission the original, one paper copy and one electronic copy of the following information. The information requested herein is due on or before March 26, 2010. Responses to requests for information shall be appropriately bound, tabbed and indexed. Each response shall include the name of the witness responsible for responding to the questions related to the information provided.

Each response shall be answered under oath or, for representatives of a public or private corporation or a partnership or association or a governmental agency, be accompanied by a signed certification of the preparer or person supervising the preparation of the response on behalf of the entity that the response is true and accurate to the best of that person's knowledge, information, and belief formed after a reasonable inquiry.

Henry District shall make timely amendment to any prior response if it obtains information which indicates that the response was incorrect when made or, though correct when made, is now incorrect in any material respect. For any request to which Henry District fails or refuses to furnish all or part of the requested information, Henry

District shall provide a written explanation of the specific grounds for its failure to completely and precisely respond.

Careful attention should be given to copied material to ensure its legibility. When the requested information has been previously provided in this proceeding in the requested format, reference may be made to the specific location of that information in responding to this request.

1. Refer to the Amended Testimony of Thomas Green at Question 7.¹ Describe the involvement of Mr. Woodcock and Mr. Cooperwasser in the development of Henry District's system development charge.

2. Identify all publications, journals and professional manuals that Mr. Green relied upon to develop the proposed system development charge.

3. State whether the electronic mail messages appended to this Request as Exhibit 1 represent all contact that Mr. Green had with Commission Staff other than the informal conference of July 21, 2009. If no, provide all other messages between Mr. Green and Commission Staff and describe any conversations in which system development charges were discussed.

4. Refer to the Amended Testimony of Thomas Green at Question 12. Mr. Green states that "[a]s suggested by Commission Staff, we have based our asset depreciation on the longest service lives listed in the 1979 NARUC study for small water utilities."

a. Identify person(s) who made this suggestion.

¹ Henry County Water District No. 2's Amended Application, Exhibit 9 (filed Feb. 10, 2010).

b. State whether the suggestion to consider revisions to the service lives of Henry District's facilities was made during a discussion of the effect of such revisions on Henry District's depreciation expense and revenue requirement.

c. State whether, during the discussion between Henry District's representatives and Commission Staff in which the suggestion arose, Commission Staff advised that any change to depreciable lives must be made on a going-forward basis using the remaining-life method with no retroactive restatement of accumulated depreciation and that any change in depreciable lives should first be discussed with the Certified Public Accountant that performs Henry District's annual audit to ensure that any change for rate-making purposes is properly reflected and accounted for in Henry District's books and records.

d. State whether Mr. Green agrees with the following: Any change to depreciable lives must be made on a going forward basis using the remaining life method with no retroactive restatement of accumulated depreciation and that any change in depreciable lives should first be discussed with the Certified Public Accountant that performs Henry District's annual audit to ensure that any change for rate-making purposes is properly reflected and accounted for in Henry District's books and records. If Mr. Green does not agree, explain why not.

5. a. Identify the Commission proceedings that Mr. Green reviewed in preparation of the proposed system development charge in which the Commission adjusted the depreciable lives assigned to plant assets or otherwise approved such adjustments.

b. Identify the studies listed in response to Item 5(a) in which the Commission approved a retroactive restatement of accumulated depreciation as a result of revising depreciable lives.

6. Identify the rate-making standards and publications that permit a retroactive restatement of accumulated depreciation as a result of changing depreciable lives.

7. a. State whether Mr. Green agrees with the following: The balance in Account 215.1, Retained Earnings From Income Before Contributions, represents the net assets upon which an equity system development charge could be based as long as it does not erroneously include contributions.

b. If yes, explain why Henry District did not use the balance of Account 215.1 as the basis for its proposed equity system development charge.

8. State whether Mr. Green believes a retroactive adjustment to Account 215.1 to account for a change to the depreciable lives assigned to Henry District's utility plant in service is appropriate and consistent with generally recognized rate-making principles. If yes, explain why and provide supporting authority for this position.

9. Explain why a retroactive adjustment to Account 215.1 to account for a change to the depreciable lives assigned to Henry District's utility plant in service would not constitute retroactive rate-making.

10. Refer to Amended Testimony of Thomas Green, Appendix A at 7. Recalculate the system development charge without restating Accumulated Depreciation.

11. At page 4 of Exhibit 4 of its Amended Application, Henry District requests recovery of depreciation expense of \$300,500. At page 4 of its 2008 Annual Report,² Henry District reported test year depreciation expense of \$807,322.

a. Show the calculations, state all assumptions, and provide the work papers used to derive the depreciation expense of \$807,322 stated in Henry District's 2008 Annual Report.

b. Show the calculations, state all assumptions, and provide the work papers used to derive the depreciation expense of \$300,500 included in the determination of Henry District's revenue requirements.

c. State whether Henry District has considered revising the depreciable lives assigned to its plant assets to conform to the rates in the National Association of Regulatory Utility Commissioners' publication *Depreciation Practices for Small Water Utilities* (1979). If yes, describe the current status of this consideration.

d. State whether Henry District agrees that its proposed rates will under fund depreciation expense by \$506,822. If no, explain why not.

e. (1) State whether Henry District is aware of the decision in *Public Service Commission v. Dewitt Water District*, 720 S.W.2d 725, 729 (Ky. 1986), which provides in part:

Depreciation is a concern to most enterprises, but it is of particular importance to water and sewer utilities because of the relatively large investment in utility plants required to produce each dollar of annual revenue. Water districts are capital intensive, asset-wasting enterprises. The structure of a water plant, comprised of innumerable components, demands

² *Annual Report of Henry County Water District No. 2 to the Public Service Commission of the Commonwealth of Kentucky for the Calendar Year Ended December 31, 2008.*

allocation of proper depreciation to ensure financial stability. Adequate depreciation allowance is critical in order to allot to the district sufficient revenue to provide for a replacement fund for all its plant property, contributed or noncontributed.

KRS 74.480 requires the Commission to establish such rates and charges for water as will be sufficient at all times to provide an adequate fund for renewals, replacement and reserves.

This statute indicates the legislative intent that water operations must have sufficient revenues to provide for depreciation.

(2) State whether Henry District agrees with the Kentucky Supreme Court's position on depreciation. If no, explain why.

f. State whether, given that it is seeking to recover only a portion of its depreciation expense through the proposed general rates for water service, Henry District is of the opinion that it can effectively and adequately operate its facilities without fully recovering depreciation expense through general service rates. Explain your response.

12. Refer to Henry District's Amended Application, Exhibit 3 at 3.

a. Explain why proposed tariff sheet states that the system development charge "will be recalculated as part of each future PSC rate case."

b. Define the term "typical residential application."

c. State the amount of water usage that constitutes typical residential application usage and describe how Henry District determines this usage.

d. Define "new customer."

e. State whether a new customer will include persons seeking water service to a property previously served but whose meter was removed.

f. Define "certification of service" as that term is used in the proposed tariff sheet.

g. Define "other unserved areas."

h. Identify the organizations to which Henry District would be certifying service.

i. Describe how Henry District will determine a person's proposed usage.

j. Explain why Henry District chose to base the system development charge upon "multiples of equivalent residential usage" instead of equivalents relative to 5/8-inch meter.

k. Describe the contents of the report that Henry District would file with the Commission and state when such report would be annually filed.

13. Explain why Henry District's Board of Commissioners reviewed and approved Mr. Green's testimony.

14. Refer to Amended Testimony of Thomas Green at Question 12. Explain why Mr. Green considers it more reasonable to use replacement costs rather than original costs to determine system equity.

15. Table 1 details payments that Henry District made to Tetra Tech during the test year.

TABLE 1		
Date Paid	Amount	Check No.
01/03/2008	6,380.00	34636
02/01/2008	3,655.00	34767
02/08/2008	2,845.00	34824
03/26/2008	830.00	35027
04/18/2008	16,070.00	35175
06/02/2008	4,420.00	35369
07/09/2008	3,952.40	35540
07/25/2008	7,055.00	35610
08/20/2008	3,245.00	35734
09/04/2008	1,650.00	35778
09/26/2008	2,160.00	35868
11/07/2008	13,905.00	36025
12/08/2008	7,315.00	36151
12/18/2008	300.00	36223
Total	73,782.40	

a. Provide a copy of the complete invoice from Tetra Tech that supports each payment shown above. The invoices should provide an itemized listing of all services that Tetra Tech provided, a detailed description of each service, and the number of hours charged for each service.

b. State the account number and account title to which each of the test year payments were charged.

c. Prepare a separate table for each year from 1999 through 2009 and from 2010 to date that lists each payment that Henry District has made to Tetra Tech. For each payment shown, provide:

- (1) Date of payment.
- (2) Amount of payment.
- (3) Check number used to make payment.
- (4) The account number and account title to which the amount was charged.
- (5) A detailed description of the services provided.
- (6) The number of hours charged for each service.

16. Table 2 is based upon information from Henry District's Amended Application, Exhibit 4 at 1, and 2008 Annual Report at 20 and 49.

TABLE 2		
	Application	Annual Report
Water Sales	\$2,868,614	\$2,879,514
Forfeited Discounts	75,026	75,026
Miscellaneous Service Revenues	25,984	46,514
Investment Income	111,787	0
Interest Income	90,000	0
Interest and Dividend Income		111,787
Total	<u>\$3,171,411</u>	<u>\$3,112,841</u>

a. Reconcile the \$25,984 amount that Henry District reported in its Amended Application as Miscellaneous Service Revenues with the amount of \$46,514 in its 2008 Annual Report.

b. State whether "Investment Income" that Henry District reported in its Amended Application refers to the same funds that Henry District reports as "Interest and Dividend Income in its Annual Report."

c. State where the \$90,000 amount that Henry District reports as "Interest Income" in its Amended Application is reported in its Annual Report.

17. Table 3 reflects information contained in Henry District's 2008 Annual Report and Henry District's Response to Commission Staff's Initial Information Request, Items 4 and 7.

a. Table 3 reflects discrepancies in the amounts reported as contributions and revenues in Henry District's Annual Report and General Ledger in the amount of \$49,609. The discrepancy appears to result from certain items reported as Other Water Revenue in the General Ledger being reported as Other Contributions in the Annual Report. Provide a reconciliation of these amounts.

TABLE 3

Per General Ledger				Per Annual Report			
Account No.	Account Title		Amount	Account No.	Account Title		Amount
Contributions:							
432	Tap on Fees		\$ 36,450	432	Tapping Fees		\$ 36,450
432	Contributinal Grants		350,000	432	Grants		350,000
433	Impact Fee		44,650	432	Other		94,260
Total Contributions			<u>\$ 431,100</u>	Total Contributions			<u>\$ 480,710</u>
				Difference			<u>\$ (49,610)</u>
Revenues:							
419.00	Interest Income						
	Bond and Interest	\$ 5,156.91					
	Cust Line Ext	38.79					
	Depreciation Fund	963.31					
	Impact Chg Escrow	1,485.75					
	Improvement Project	1,485.82					
	Operations	711.51					
	Revenue Acct	2,223.61					
	Interest Other	99,721.26	\$ 111,786.96	419	Interest and Dividend Income		\$ 111,787
	Metered Sales						
461.11	Henry	2,083,855.74					
461.12	Trimble	312,636.66					
461.13	Carroll	12,048.57					
461.14	Oldham	94,491.68					
461.18	Eminence	53,877.16		461	Metered Water Sales	2,661,319	
461.19	Shelby	105,608.57	2,662,518.38	462.1	Public Fire Protect.	1,200	2,662,519
461.20	Wholesale	216,995.10	216,995.10	466	Sales for Resale		216,995
470.00	Penalties / Late Fees		75,026.22	470	Forfeited Discounts		75,026
	Other Water Revenue						
471.10	Connect and Transfer	20,530.00					
472.10	Credit Card Service	3,295.53					
473.10	Bank Charges for RC	3,994.83					
474.10	Door Collection Fee	1,070.00					
475.10	Mis Income	67,232.84	96,123.20	471	Miscellaneous Service Revenues		46,514
Total Revenues			<u>\$ 3,162,449.86</u>	Total Revenues			<u>\$ 3,112,841</u>
				Difference			<u>\$ 49,609</u>

b. Item 7 includes Audit Adjustment number 34, which increases plant and miscellaneous income by \$35,200 to include donated lines. The audit adjustment is included in Account 475.1 on line 10831 of the Excel spreadsheet that Henry District provided in response to Item 4.

(1) State whether Henry District agrees that this \$35,200 is the amount that created the \$49,609 difference in the General Ledger and Annual Report.

(2) If yes:

(a) Describe how the adjustment was made to the audited balances shown in the General Ledger when preparing the Annual Report.

(b) Explain why the adjustment was made to the audited balances shown in the General Ledger when preparing the Annual Report.

(c) State why such an adjustment was not also made to the General Ledger so that the account balances shown in the General Ledger match those shown in the Annual Report.

c. State whether Henry District refunds the cost of 50 feet for each additional customer connecting to the line extension accounted for in Audit Adjustment 34 to those who paid for the construction of the line. If no, explain why not.

d. (1) State whether Henry District agrees that its books of original entry do not use the account names and titles shown in the Uniform System of Accounts that the Commission prescribes.

(2) If Henry District does not agree, explain why not.

(3) If Henry District agrees,

(a) Explain why Henry District is not using the prescribed account names and titles.

(b) State the date Henry District will complete revision of its accounting system using the proper account titles and numbers.

18. Refer to Henry District's Response to Commission Staff's Initial Information Request, Item 6. Given the discrepancy noted in the previous question, explain why Henry District states that "[a] reconciliation of test-period general ledger expense to the expense in Henry District's annual report is not needed".

19. Refer to Henry District's Response to Commission Staff's Initial Information Request, Item 4, Excel Spreadsheet Line No. 10726.

a. Describe the services that Henry District performs in return for the fees charged to Account 474.1, At Door Collection Fee.

b. Identify the pages in Henry District's filed tariff where the fees generating the revenues charged to this account appear.

20. Refer to Henry District's Response to Commission Staff's Initial Information Request, Item 4. Explain each of the following entries to Account 475.1 - Miscellaneous Income that are listed in Table 4.

TABLE 4		
Date of Entry	Type of Transaction	Amount
2/11/08	Revenue	806.91
3/21/08	Revenue	566.72
4/27/08	Revenue	2,628.44
6/2/08	Revenue	720.00
6/25/08	Revenue	1,791.38
6/25/08	Revenue	1,435.60
9/18/08	Revenue	2,657.46
10/23/08	Revenue	1,105.00
10/28/08	Revenue	567.12
10/31/08	Revenue	649.29
11/29/08	Revenue	2,754.38
12/30/08	Revenue	4,235.48
12/31/08	Audit Adj.	6,666.00
12/31/10	Audit Adj.	2,845.00

21. Refer to Henry District's Response to Commission Staff's Initial Information Request, Item 4, Account 618.1, Chemicals.

a. Provide the invoice from Southeastern Laboratories, Inc. in the amount of \$23,804.53 that was reported on May 22, 2008.

b. Describe the item(s) included on this invoice.

c. (1) State whether Henry District received bids from other vendors for the invoiced item(s).

(2) If yes, provide a copy of each bid received.

22. Refer to Henry District's Response to Commission Staff's Initial Information Request, Items 4 and 7. Table 5 lists the entries from Account 620.1 - Materials and Supplies.

TABLE 5		
Date of Entry	Type of Transaction	Amount
3/3/08	Expense	5,899.97
5/13/08	Expense	9,848.32
6/2/08	Expense	8,687.54
7/9/08	Expense	5,858.81
8/8/08	Expense	6,391.62
9/4/08	Expense	15,165.38
10/6/08	Expense	5,889.32
11/7/08	Expense	9,846.66
12/8/08	Expense	8,609.20
Total*		<u>76,196.82</u>
12/31/08	Audit Adj.	12,757.00
12/31/08	Audit Adj.	16,680.19
*All amounts paid to Waller's Meter, Inc.		

a. Provide each invoice charged to this account from Waller's Meter, Inc.

b. Provide a detailed explanation for each invoice.

c. The two audit adjustments included in Table 5 above are presented in Item 7 as Audit Adjustments 26 and 33. Provide the audit work papers that support these adjustments.

23. a. State the number of meter installations that were performed by Henry District employees during the test year.

b. State the number of meter installations that were performed by outside contractors during the test year.

24. For each water distribution main extension that was constructed during the test period and not financed through the proceeds of a bond issuance or other long-term debt, provide the following information:

a. Total cost of the extension;

b. Length of the extension;

c. Diameter of main;

d. Type of material;

e. Who (i.e., Henry District employees or outside personnel) performed the main's installation;

f. Whether the construction was performed to serve an applicant or group of applicants; and

g. Whether the construction was performed to serve a subdivision or at the request of a subdivision developer.

25. Refer to Henry District's Response to Commission Staff's Initial Information Request, Item 4, Account 620.2 - Service Department Supplies. Table 6 lists items included in this Account.

TABLE 6		
Date of Entry	Type of Transaction	Amount
2/8/08	Expense	4,894.85
5/28/08	Expense	975.00
6/11/08	Expense	1,230.88
7/16/08	Expense	1,152.87
7/16/08	Expense	3,542.60
12/19/08	Expense	1,103.30

- a. Provide the vendor invoices supporting these payments.
- b. For each invoice, provide an explanation of each invoiced item to include the necessity and use of each item.

26. a. List each credit card account and credit card plan that Henry District currently has.

b. List each Henry District official and employee who holds a credit card issued to Henry District.

c. State whether Henry District has a written policy regarding the use of credit cards and credit plans. If yes, provide a copy of each policy that is currently in effect for each credit card and credit plan.

27. Refer to Henry District's Response to Commission Staff's Initial Information Request, Item 4, Account 631.2 - Cont Serv Plant and Item 7, Audit Adjustment 25.

a. Provide the invoice from Micro Comm Digital Control Technology in the amount of \$10,800 as charged to account 631.2.

b. Provide the audit work papers that support Audit Adjustment 25 reclassifying prepaid maintenance.

28. Refer to Henry District's Response to Commission Staff's Initial Information Request, Item 4, Account 633.8 - Legal. Provide the invoices supporting

each charge to this account. The invoices should include a detailed description of the services provided, the amount of time devoted to each service, and the amount charged for each service.

29. Refer to Henry District's Response to Commission Staff's Initial Information Request, Item 4, Account 634.2 - Cont Serv – Meter Reading. Provide Henry District's current contract for meter reading services. If a contract does not exist, provide a detailed description of the meter reading services provided and how monthly meter reading charges are determined.

30. Refer to Henry District's Response to Commission Staff's Initial Information Request, Item 4, Account 634.3 - Contract Serv MGT MAINT.

- a. Describe the services provided for the \$246.46 monthly fee.
- b. State the name of the vendor.
- c. Provide a copy of the contract associated with this expense.

31. Refer to Henry District's Response to Commission Staff's Initial Information Request, Item 4, Account 636 - Contractual Services. Provide the invoice supporting the payment made to Reynolds, Inc. in the amount of \$1,950.

32. Refer to Henry District's Response to Commission Staff's Initial Information Request, Item 4, Account 650.5 - Bkhoe & Truck Fuel. Describe the services that Bullock Oil Co. provided for each payment charged to this account.

33. Refer to Henry District's Response to Commission Staff's Initial Information Request, Item 4, Account 650.8 - Mileage. Table 7 summarizes most of the entries to this account for payments made for mileage. State the reason that each of these individuals was compensated for mileage in the amounts shown.

TABLE 7	
Name	Total Payments
Barry Woods	12,238.62
Bobbey Simpson	1,743.66
Chris Troxell	811.53
Jay Armstrong	469.20
Jerry Rankin	1,380.82
Jimmy Simpson	4,049.34
Keith Morris	3,889.92
Lisa Coots	345.91
Lynda Wilson	254.36

34. Provide a copy of all written travel expense policies that Henry District's Board of Commissioners had in effect in 2008 or has subsequently adopted.

35. Provide a copy of all written employee reimbursement policies that Henry District's Board of Commissioners had in effect in 2008 or has subsequently adopted.

36. Refer to Henry District's Response to Commission Staff's Initial Information Request, Item 4, Account 675.7 - Plant & Well Repair, and Item 7, Audit Adjustment 31.

a. Table 8 contains entries taken from Account 675.7. For each entry, provide the vendor invoice and a detailed explanation of the necessity and use for each item shown on the invoice.

b. Refer to the amount shown in Table 8 paid to John Roehrig.

(1) State whether Henry District requested bids for the services provided in return for this payment?

(2) (a) If yes, provide a copy of all bids.

(b) If no, state why KRS 424.260 did not require Henry District to obtain bids for these services.

c. Audit Adjustment 7 appears to accrue expenses to Account 675.7 that were payable at the end of the test year in the amount of \$9,690.50.

(1) Provide a copy of vendor invoices supporting this accrual.

(2) Provide a detailed explanation for each invoiced item that includes the necessity and use for each invoiced item.

TABLE 8		
Date	Amount	Vendor
1/3/08	2,255.00	Johnson All Service, Inc.
2/1/08	2,034.60	Gatterdam's Electric
2/8/08	1,564.87	Living Waters Co., Inc.
2/21/08	2,222.00	RCD International
2/27/08	8,185.00	Johnson All Service, Inc.
3/26/08	8,376.95	Quality Electric Motor Service
4/9/08	3,954.16	Guthrie Sales and Service
4/18/08	25,000.00	John Roehrig
4/18/08	3,109.25	J&J Services, Inc.
4/25/08	7,000.00	Wet or Dry
6/2/08	3,961.00	Johnson All Service, Inc.
7/1/08	5,644.00	RJ Vissing Associates
7/16/08	6,716.00	Johnson All Service, Inc.
7/18/08	1,086.00	Chase Card Services
7/25/08	1,219.60	American Precision Supply, Inc.
8/1/08	4,173.69	J&J Services, Inc.
8/29/08	1,617.00	Gatterdam's Electric
10/24/08	6,136.00	Living Waters Co., Inc.
11/7/08	5,784.00	Reynolds, Inc.
11/7/08	1,630.80	Grainger
12/15/08	1,478.00	Walt's Pump Repair Service
12/19/08	1,092.65	Furmanite

37. Refer to Henry District's Response to Commission Staff's Initial Information Request, Item 4, Account 682.1 - Reprs, Serv, Dept. Equip.

a. Provide the vendor invoices supporting the payments of \$1,761.27, \$3,524.79, and \$6,495.41 made to Hunt Tractor, Inc.

b. Describe the need and use for each item shown on these invoices.

38. Refer to Henry District's Response to Commission Staff's Initial Information Request, Item 4, Account 685.1 - Miscellaneous Exp. There are three

entries to this account totaling \$3,974.78 paid to "Make a Memory." The memo note included on the General Ledger for these three entries reads "employees ½ down t shirts etc."

- a. Provide the vendor invoice that supports these charges.
- b. Explain the need and use for each item shown on the invoices.

39. Refer to Henry District's Response to Commission Staff's Initial Information Request, Item 3.

- a. Provide a copy of the "dozer" lease agreement.
- b. Provide a copy of the payment schedule for this lease that shows the amount of each payment and the portion of each payment that is attributable to interest and principal.

40. Refer to Henry District's Original Application, Exhibit 6 at 15, Note 8 – Long-Term Debt. Provide the auditor's work papers supporting this note to Henry District's financial statements.

41. Refer to Henry District's Amended Application, Exhibit 4 at 5. Provide all work papers used to determine the adjustments to Salaries and Wages, Purchased Power, and Plant Wellfield Repairs in the amounts of \$29,906, \$36,650, and (\$50,000), respectively. These work papers shall include the actual calculation of the adjustments as well as supporting documentation for all the assumptions made to develop the adjustments.

42. Refer to Henry District's Response to Commission Staff's Initial Information Request, Item 4, Account 631.10 - Cont Serv Mowing and Account 631.40 - Office Cleaning.

a. State whether the amounts charged to these accounts are paid to Henry District employees.

b. State the length of time that each employee has performed these services.

c. Identify the entities that performed these services prior to the current employees and state the amount charged by those entities to perform these services.

d. Describe the internal controls that are in place to ensure that these employees do not perform contracted services during hours that they are paid as Henry District employees.

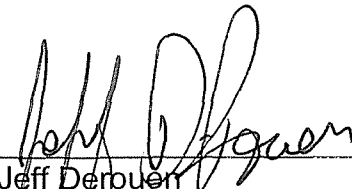
43. On February 3, 2010, the Commission approved an increase in connection fee/transfer fee for Henry District from \$25 to \$35.³ Describe the effects of this increase on Henry District's test year revenues. Show all calculations, state all assumptions and provide all work papers used to formulate your response.

44. State whether Henry District has adopted the Local Model Procurement Code. If no, provide all of Henry District's current written policies that address procurement practices for goods and services.

45. Provide a copy of the resolutions of Henry, Shelby, Oldham, Trimble and Carroll Counties approving the current level of compensation for members of Henry District's Board of Commissioners.

³ Case No. 2009-00445, *Application of Henry County Water District No. 2 for Approval of Nonrecurring Charges* (Ky.PSC Feb 3, 2010).

46. Describe the actions, if any, that Henry District has taken since January 1, 2008 to reduce its electric power costs.



Jeff Derpuen
Executive Director
Public Service Commission
P.O. Box 615
Frankfort, Kentucky 40602

DATED: MAR 12 2010

cc: Parties of Record

EXHIBIT 1

Wuetcher, Jerry (PSC)

From: Green, Tom [Thomas.Green@tetratech.com]
Sent: Thursday, July 23, 2009 12:14 PM
To: Lawless, Scott (PSC)
Cc: Wuetcher, Jerry (PSC); Carryn Lee; baxterlaw@me.com
Subject: Henry District Equity SDC question
Scott,

EXHIBIT
1-A

Thanks for your input Tuesday at the Henry District SDC meeting- we thought it was very constructive. We have a follow-up question for you to mull over.

Using your rough estimate of \$3,000,000 in HCWD equity, and a ballpark system capacity of 10,000 residential customers, we would arrive at an equity SDC of about \$300. The Offsetting Improvement Charge calculated the cost of capacity expansion to accommodate growth at \$950 per lot for the distribution system alone. Including water intake, treatment, and storage, the total would have been at least \$1500, and so the \$950 OIC actually offset only about 60% of growth costs. But using an alternative equity SDC of \$300 per lot would pick up only 20% of those costs.

We are looking for legitimate ways for the equity SDC alternative to achieve the District's goal of new customers paying a reasonable portion of the cost of replacing the system capacity they consume.

The SDC chapter in the M-1 Manual says that in the equity method the original costs of assets may be adjusted to recognize the cost of replacing those assets, and that "the reproduction cost valuation reflects equity contributions made by existing customers in terms of current dollars." Since the new customer buys-in with current dollars, the reproduction cost basis seems fair, particularly in Henry District's situation. Unlike the typical application cited by the AWWA for using equity SDCs in systems which are essentially built out and not in need of expansion, Henry District will need to replace miles of small diameter lines with larger capacity lines as growth continues. So it would seem more appropriate to use reproduction costs as the equity SDC basis. Henry District would be willing to limit the use of SDC proceeds to capacity expansion projects in order to justify the rationale of using replacement costs as the basis of the SDC.

That do you think about this?

Thanks,

Tom Green

Thomas Green| Senior Technician
Direct: 859 514 6607 | Main: 859 223 8000
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Tetra Tech, Inc.
Suite 200 | 800 Corporate Drive | Lexington, KY 40503 | www.tetratech.com

EXHIBIT 1-B

Wuetcher, Jerry (PSC)

From: Wuetcher, Jerry (PSC)
Sent: Friday, July 24, 2009 12:22 PM
To: 'Green, Tom'
Cc: 'baxterlaw@me.com'; 'Damon Talley'; Spenard, David (KYOAG); Carryn Lee (cjlee52@roadrunner.com); Lawless, Scott (PSC); Reid, Sam H (PSC); Rice, James D (PSC)
Subject: Henry County Water District No. 2 - System Development Charge

Tom,

This message represents Commission Staff's response to your electronic mail message of 23 July 2009.

In your message, you state that Henry County Water District is looking for legitimate ways for the equity SDC to require new customers to pay for replacing system capacity. You further state that the "district will need to replace miles of small diameter lines with larger capacity lines as growth continues. So it would seem more appropriate to use reproduction costs as the equity SDC basis." According to the AWWA M-1 Manual, the equity SDC is intended to achieve an equity position between new and existing customers. An SDC based upon the incremental methodology, not the equity methodology, would be more appropriate if the purpose of the SDC is to replace and expand system capacity. Please note that if the stated purpose of an equity methodology-based SDC is replacement and expansion of system capacity, it may create some confusion in any proceeding before the PSC and may subject the utility's proposal to greater scrutiny (and thus more extensive discovery requests) from intervenors and the Commission.

In your e-mail you discuss the M-1 Manual making reference to the use of reproduction costs when calculating an equity SDC. The M-1 manual does make this reference but note that it also mentions that the use of reproduction costs is subject to rules and regulations of the regulatory body. The Ky PSC has used original cost accounting since its inception in 1934. Commission Staff does not dispute Henry District's right to propose a SDC charge that is based upon reproduction costs. As the use of such costs will represent a significant change in longstanding PSC practice, the PSC will likely devote significant attention to this aspect of Henry District's proposal. Simply put, the use of reproduction costs will likely result in extensive discovery requests by the Commission and any intervenors on the reasonableness of using such costs and may increase the complexity and expense of the review proceeding.

In addition, the comments in your e-mail regarding "current dollars" imply that an equity SDC should be adjusted to account for the time value of money. If the district were to request an equity SDC adjusted for the time value of money and, in doing so, made adjustments to the original cost of plant in service for the time value of money, Commission Staff believes that all numbers used in the calculation of the SDC, such as accumulated depreciation and contributions in aid of construction, would also require adjustment for the time value of money.

If you have further questions, please feel free to contact Commission Staff.

Sincerely,

Gerald E. Wuetcher
Executive Advisor
Public Service Commission of Kentucky
(502) 564-3940, Extension 259
(502) 229-6500 (cell)
gerald.wuetcher@ky.gov

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Tracking:

Recipient

Read

'Green, Tom'

'baxterlaw@me.com'

Recipient**Read**

'Damon Talley'

Spenard, David (KYOAG)

Carryn Lee (cjlee52@roadrunner.com)

Lawless, Scott (PSC)

Reid, Sam H (PSC)

Rice, James D (PSC)

Read: 7/24/09 1:20 PM

Read: 7/24/09 12:23 PM

Read: 7/24/09 1:15 PM

Wuetcher, Jerry (PSC)

From: Green, Tom [Thomas.Green@tetrattech.com]
Sent: Monday, July 27, 2009 10:31 AM
To: Spenard, David (KYOAG); Wuetcher, Jerry (PSC)
Cc: baxterlaw@me.com; Damon Talley; cjlee52@roadrunner.com; Lawless, Scott (PSC); Reid, Sam H (PSC); Rice, James D (PSC); jamestsimpson@att.net
Subject: RE: Henry County Water District No. 2 - System Development Charge

**EXHIBIT
1-C**

All,

This response is intended to address both the emails of David Spenard and Jerry Wuetcher, below.

It was the AWWA's guidance concerning the most appropriate conditions for using equity SDC methodology that prompted Henry District to write to PSC Executive Director Derouen in February. We asked if, having reviewed the District's circumstances in Case 2006-00191, the Commission in its December 2008 Order endorsed the use of the equity methodology in Henry County. Mr. Derouen responded that Commission Staff interpreted the Order "as an endorsement of Henry District's use of the equity methodology."

The fact that small diameter lines will need to be replaced in the Henry District as customer growth continues is not a new piece of information; it is a circumstance fundamental to the rationale and calculation of the Offsetting Improvement Charge. It was addressed at length during that case, and known to the Commission prior to its endorsement of the use of equity methodology in the Henry District.

The OIC focused only on the costs of growth in the distribution system and excluded the costs of intake, treatment, and storage. It therefore was found to fall short of the Commission's definition of a system development charge. "Moreover, the Offsetting Improvement Charge does not fall within the parameters of 807 KAR 5:090 or system development charges generally. It is limited to a specific type of system improvement - the installation of water distribution mains to replace or supplement existing water distribution mains that are deemed inadequate. Generally, system development charges are intended to recover all costs related to system development or expansion."

In rejecting the OIC, the Commission issued a time extension: "This grace period will permit Henry District sufficient time to develop and to file with the Commission an alternative mechanism that *comprehensively addresses the allocation of costs associated with customer growth*. We remind Henry District that the Commission has previously recognized the equity method as *an acceptable means of allocating such costs*." (emphasis added)

If the District is to develop and file an alternative mechanism in the form of an equity SDC which comprehensively addresses the costs of customer growth, as the Commission directs, the resulting charge should produce revenues which reasonably approximate those costs.

The AWWA acknowledges a middle ground between those systems which face major growth expense (typically incremental SDCs) and other systems with capacity in excess of their needs (typically equity SDCs). The AWWA states "In many instances, particularly where some reserve capacity for growth is available and new capacity is planned, a combination of the two methods may be appropriate." Henry District fits into this middle category, in some ways our system has excess capacity, in other ways our system will need expansion. The AWWA says "in many cases" a combination of methods is appropriate, so it would not break new ground to make appropriate SDC modifications such as the use of replacement cost equity valuation. It would set system cost squarely in the present, higher than the original cost of facilities, but lower than the projected *future* cost of an incremental SDC ten year capital improvement plan (a future cost basis which is acceptable to the Commission notwithstanding its long practice of original cost accounting).

In finding the OIC to be an incomplete approach, the Commission in Case 2006-00191 pointed out that SDCs "are intended to recover all costs related to system development or expansion" and set out for Henry District the task of developing an alternative mechanism which comprehensively addresses the allocation of costs associated with customer growth. As a means of achieving that specific end, wouldn't the limited use of replacement costs in Henry District's equity SDC calculation be appropriate, not only to

the District's circumstances, but also to the specific guidance it has received from the Commission?

Thanks,

Tom

Thomas Green| Senior Technician
Direct: 859.514.0801 | Main: 859.223.0060

tom.green@tetratech.com

http://www.tetratech.com

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Suite 200 | 800 Corporate Drive | Lexington, KY 40503 | www.tetratech.com

From: Spenard, David (KYOAG) [mailto:david.spenard@ag.ky.gov]

Sent: Friday, July 24, 2009 2:37 PM

To: Wuetcher, Jerry (PSC); Green, Tom

Cc: baxterlaw@me.com; Damon Talley; cjee52@roadrunner.com; Lawless, Scott (PSC); Reid, Sam H (PSC); Rice, James D (PSC)

Subject: RE: Henry County Water District No. 2 - System Development Charge

Good afternoon,

The pertinent section of the AWWA M1 (Fifth Edition) states, with regard to valuation of system assets under the equity method: "For SDC purposes, one measure of the valuation of the system assets is the original value of the total plant less accumulated depreciation." (Page 201.) Thereafter, it states: "This value *may* be adjusted to recognize the cost of reproducing the or replacing assets, depending on the rules and regulations of the applicable regulatory body." (*Id.* emphasis added.) The AWWA M1, a guidance document, does not impel let alone require an such an adjustment. For this issue, the OAG has significant concerns with the use of reproduction costs for the valuation of system assets.

Additionally, with regard to the equity method, AWWA M1 states: "This approach [the equity method] is most appropriate where current system facilities adequately serve existing and future customers, where no significant system investment is anticipated, and where existing facilities are not scheduled for replacement in the near future." (*Id.*) The text states "most appropriate" rather than "only appropriate." Nonetheless, if the proposal is for replacing small diameter lines with larger capacity lines as growth continues, then, from the OAG's position, the applicant may want (or at least be prepared) to discuss the issue of the appropriateness of an equity SDC for that set of facts.

In terms of notice it is appropriate to again point out that in addition to its misgivings on the issue of a "reproduction cost" valuation approach, the OAG still has other qualms concerning the equity method.

Regards,

David

From: Wuetcher, Jerry (PSC) [mailto:JWuetcher@ky.gov]

Sent: Friday, July 24, 2009 12:22 PM

To: Green, Tom

Cc: baxterlaw@me.com; Damon Talley; Spenard, David (KYOAG); cjlee52@roadrunner.com; Lawless, Scott (PSC); Reid, Sam H (PSC); Rice, James D (PSC)

Subject: Henry County Water District No. 2 - System Development Charge

Tom,

This message represents Commission Staff's response to your electronic mail message of 23 July 2009.

In your message, you state that Henry County Water District is looking for legitimate ways for the equity SDC to require new customers to pay for replacing system capacity. You further state that the "district will need to replace miles of small diameter lines with larger capacity lines as growth continues. So it would seem more appropriate to use reproduction costs as the equity SDC basis." According to the AWWA M-1 Manual, the equity SDC is intended to achieve an equity position between new and existing customers. An SDC based upon the incremental methodology, not the equity methodology, would be more appropriate if the purpose of the SDC is to replace and expand system capacity. Please note that if the stated purpose of an equity methodology-based SDC is replacement and expansion of system capacity, it may create some confusion in any proceeding before the PSC and may subject the utility's proposal to greater scrutiny (and thus more extensive discovery requests) from intervenors and the Commission.

In your e-mail you discuss the M-1 Manual making reference to the use of reproduction costs when calculating an equity SDC. The M-1 manual does make this reference but note that it also mentions that the use of reproduction costs is subject to rules and regulations of the regulatory body. The Ky PSC has used original cost accounting since its inception in 1934. Commission Staff does not dispute Henry District's right to propose a SDC charge that is based upon reproduction costs. As the use of such costs will represent a significant change in longstanding PSC practice, the PSC will likely devote significant attention to this aspect of Henry District's proposal. Simply put, the use of reproduction costs will likely result in extensive discovery requests by the Commission and any intervenors on the reasonableness of using such costs and may increase the complexity and expense of the review proceeding.

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If you have further questions, please feel free to contact Commission Staff.

Sincerely,

Gerald E. Wuetcher
Executive Advisor
Public Service Commission of Kentucky
(502) 564-3940, Extension 259
(502) 229-6500 (cell)
gerald.wuetcher@ky.gov

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Wuetcher, Jerry (PSC)

From: Green, Tom [Thomas.Green@tetrattech.com]
Sent: Monday, September 21, 2009 3:20 PM
To: Lawless, Scott (PSC)
Cc: baxterlaw@me.com; jamesstimpson@att.net; Carryn Lee; Wuetcher, Jerry (PSC)
Subject: Henry District SDC questions

**EXHIBIT
1-D**

Scott,

At its September 8 meeting the Henry District decided to submit an equity SDC based on original costs rather than take on the additional expense and effort of seeking approval of replacement cost methodology. We are attempting to submit our application as soon as possible to reduce the likelihood of a gap between the expiration of the OIC and the approval of the new charge.

The April 2, 2009 letter from Jeff Derouen contained the Commission Staff's recommendation that in order to use equity methodology the District could request waivers from several sections of 807 KAR 5:090. The letter also recommended that we "provide detailed information on the water system's liabilities and equity and all sources of equity in its application."

Section 3 of 807 KAR 5:090 states that the utility shall file "the prepared testimony of each witness the applicant proposes to call in a hearing on its application." Because we have reason to believe the Commission supports the use of the equity methodology for Henry District, we do not anticipate a hearing. Do you think it could be acceptable for the filing of testimony to be waived?

Does the District's most recent "Statement of Retained Earnings" provide an adequate and acceptable summation of grants?

Can all savings accounts, CDs, etc be added to the equity calculation, regardless of whether they are dedicated to a restricted purpose?

Can you provide us a copy of (or an internet link to) the 1979 NARUC study which is referenced in Grayson Case 2008-00057?

Is there a recent PSC case which exemplifies an acceptable "remaining life" method of estimation?

Thanks,

Tom Green

Wuetcher, Jerry (PSC)

From: Green, Tom [Thomas.Green@tetrattech.com]
Sent: Friday, October 02, 2009 11:45 AM
To: Spenard, David (KYOAG)
Cc: Wuetcher, Jerry (PSC)
Subject: FW: Henry District SDC questions

**EXHIBIT
1-E**

David,

Sorry I didn't have you on the Cc list of my Sept 21 email. Jerry said yesterday that they would be responding shortly.

Tom

From: Green, Tom
Sent: Monday, September 21, 2009 3:20 PM
To: Lawless, Scott (PSC)
Cc: baxterlaw@me.com; 'jamestsimpson@att.net'; 'Carryn Lee'; Wuetcher, Jerry (PSC)
Subject: Henry District SDC questions

Scott,

At its September 8 meeting the Henry District decided to submit an equity SDC based on original costs rather than take on the additional expense and effort of seeking approval of replacement cost methodology. We are attempting to submit our application as soon as possible to reduce the likelihood of a gap between the expiration of the OIC and the approval of the new charge.

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Can all savings accounts, CDs, etc be added to the equity calculation, regardless of whether they are dedicated to a restricted purpose?

Can you provide us a copy of (or an internet link to) the 1979 NARUC study which is referenced in Grayson Case 2008-00057?

Is there a recent PSC case which exemplifies an acceptable "remaining life" method of estimation?

Thanks,

Tom Green

3/12/10

Wuetcher, Jerry (PSC)

**EXHIBIT
1-F**

From: Green, Tom [Thomas.Green@tetrattech.com]

Sent: Monday, October 26, 2009 12:16 PM

To: Wuetcher, Jerry (PSC)

Cc: Spenard, David (KYOAG); Lawless, Scott (PSC); baxterlaw@me.com; jamessimpson@att.net; cjlee52@roadrunner.com; Damon R. Talley; Reid, Sam H (PSC)

Subject: RE: Henry County Water District No. 2 - SDC Questions

Mr. Wuetcher,

Thank you for the information. We are working on testimony which will address the need for, and methodology of, the proposed SDC. Because our circumstances have been examined in both OIC cases, and because the equity methodology was suggested to us by the Commission, we would hope that it's appropriateness in our circumstances would not be a significant issue.

We are working out certain details of an equity SDC which we have been unable to find addressed in the AWWA SDC chapter, in PSC Administrative Case 375, or in 807 KAR 5:090.

The District would appreciate the guidance of Commission Staff regarding what constitutes a "new" customer who is required to pay an equity SDC.

If a person who has never been a District customer buys an existing home where HCWD water service had long been provided, is he a considered a new customer even though he is not consuming surplus capacity but only taking the place of an existing user who has left the District?

If a person who was in the past an HCWD customer, moves away then subsequently returns, is he considered a new customer? If not, what previous length of time would Staff suggest as reasonable for exemption from an equity SDC?

Also, the KAR discusses charging an SDC to an existing customer who significantly increases demand. Would this also apply to an equity SDC? If so, at what point is the increase in demand significant enough to warrant charging an equity SDC to an existing customer?

Thanks,

Tom Green

From: Wuetcher, Jerry (PSC) [mailto:JWuetcher@ky.gov]

Sent: Thursday, October 08, 2009 4:52 PM

To: Green, Tom

Cc: Spenard, David (KYOAG); Lawless, Scott (PSC); baxterlaw@me.com; jamessimpson@att.net; cjlee52@roadrunner.com; Damon R. Talley; Reid, Sam H (PSC)

Subject: Henry County Water District No. 2 - SDC Questions

Mr. Green:

I apologize for the delay in responding. The answers to the questions contained in your message of 9/21/2009 are as follows:

Question: Should the requirement in 807 KAR 5:090 for filed testimony be waived in the case of HCWD2?

Answer: (Please note that the Commission determines whether a deviation is granted, not PSC Staff.) Commission Staff is not likely to recommend that a deviation from this requirement be granted. The requirement for testimony is intended to ensure a full and complete record and that the utility has an adequate opportunity to present its case and meet its statutory burden of proof. The testimony would contain the basis for the WD's need for an SDC and support of its proposed methodology. While the PSC has encouraged HCWD2 to consider the use of the equity methodology, it has not make a definitive ruling. The utility must still prove its case. The utility has discretion in the length and detail of its filed testimony. The regulation does not specify how lengthy or detailed that the testimony must be. HCWD2 may meet the regulation's filing requirements, and thus have its application accepted for filing purposes,

3/12/10

with written testimony that is limited in detail and length. The utility may also request in its application that the record of Case No. 2006-00191 be incorporated by reference into the record of any new proceeding. Please note that the filed testimony is one of the few opportunities for the water district to present its case, to tell its story. In my opinion, it is one of the most important parts of the case. Presenting limited or no testimony prevents the water district from providing the PSC with a clear picture of the WD's needs and WD's reasoning for an SDC.

Question 2: Does HCWD2's most recent "Statement of Retained Earnings" provide an adequate and acceptable summation of grants?

Answer: Commission Staff does not understand the question. Grants should be excluded from the equity of the system upon which the equity buy-in SDC is to be calculated. During any review of an application for an equity buy-in SDC, the PSC must determine whether grants that HCWD2 has received have been properly accounted for as contributions in aid of construction and not as revenue. If accounted for as revenue, such grants would have been improperly included in the retained earnings balance upon which HCWD2 seeks to establish its SDC.

Question 3: May all savings accounts, CDs, etc., be added to the equity calculation regardless of whether they are dedicated to a restricted purpose?

Answer: Commission Staff does not understand the question, but is of the opinion that all retained earnings accumulated from the receipt of monthly water service fees should be included in the calculation of the SDC.

Question 4: Provide a copy of the 1979 NARUC Study that is referenced in Case No. 2008-00057.

Answer: It is attached to this message.

Question 5: Identify a recent PSC case that exemplifies an acceptable remaining life method of estimation.

Answer: Remaining life depreciation is a standard practice in utility ratemaking and accounting that the Commission uses in all depreciation studies. Attached is a copy of a study that was performed in Case No. 2007-00143. Also attached is an order of the PSC assessing a study recently submitted by Northern Kentucky Water District. PSC Staff has employed much simpler methods of calculating remaining life depreciation in rates cases for smaller water utilities. See, e.g., Case No. 2008-00057.

Sincerely,

Gerald E. Wuetcher

Executive Advisor

Public Service Commission of Kentucky

(502) 564-3940, Extension 259

(502) 229-6500 (cell)

gerald.wuetcher@ky.gov

<<Depreciation Practices for Small Water Utilities_1979.pdf>> <<2006-00398 FO.doc>> <<KAW_DT_JJS_043007.pdf>>

Merle Brewer
Chairman
Henry County Water District #2
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