

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, CONSTRUCT)	CASE NO. 2009-00370
AND FINANCE A PROPOSED WATERWORKS)	
PROJECT, AND IMPLEMENT A SYSTEM)	
DEVELOPMENT CHARGE)	

ORDER

Henry County Water District No. 2 ("Henry District") has applied to adjust its rates for water service to produce additional annual revenues from water sales of \$542,415, an increase of 18.83 percent over reported test period water sales. By this Order, we establish rates that will produce additional revenues of \$496,497, an increase of 17.23 percent.

BACKGROUND

Henry District, a water district organized pursuant to KRS Chapter 74, provides water service to approximately 6,310 customers in the counties of Carroll, Henry, Oldham, Shelby and Trimble.¹ A seven member Board of Commissioners controls and manages Henry District's affairs.

PROCEDURE

On November 16, 2009, Henry District tendered to the Commission an application for an adjustment of its water service rates, a Certificate of Public Convenience and Necessity to construct an improvement project; approval of a

¹ *Annual Report of Henry County Water District No. 2 to the Public Service Commission for the Calendar Year Ended December 31, 2008 ("Annual Report")* at 5 and 27.

proposed plan to finance the improvement project, authority to assess a system development charge. Pursuant to 807 KAR 5:001, Section 2(2), the Commission's Executive Director rejected this application because of its failure to comply with applicable Commission regulations.

On February 11, 2010, Henry District filed with the Commission an amended application in which it requested a rate adjustment and authority to assess a system development charge but withdrew its request for a Certificate of Public Convenience and Necessity for a waterworks improvement project and authority to issue evidences of indebtedness to finance that project. On April 15, 2010, Henry District moved to withdraw its application to assess a system development charge. The Commission granted this motion on May 7, 2010.

Following the filing of Henry District's amended application, the Commission found that further investigation into the reasonableness of Henry District's proposed rates was necessary and suspended the proposed rates until August 15, 2010. Subsequently the Commission, on its own motion or through Commission Staff, conducted discovery.

On June 11, 2010, Henry District and Commission Staff entered into and filed with the Commission a stipulation of facts. Concurrent with the filing of this stipulation, Henry District moved that this matter be submitted for decision based upon the existing record and without any hearing.² On June 14, 2010, the Commission granted this motion and directed that the case stand submitted for decision.

² The Attorney General ("AG") is the only party to intervene in this matter. The Commission granted his motion for leave to intervene in this proceeding on October 30, 2009. Although the AG is not a signatory to the stipulation between Henry District and Commission Staff, he reviewed and does not dispute its contents or its introduction into the evidentiary record. The AG furthermore did not object to the submission of the case for decision without a hearing.

FINDINGS OF FACT

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

1. Henry District's proposed test period - the calendar year ended December 31, 2008 – is reasonably reflective of Henry District's operations and is representative of the conditions that will prevail in the immediate future when any approved rate adjustment becomes effective.

2. Henry District reports total test period operating expenses of \$2,869,040, which includes Operation and Maintenance Expenses of \$2,005,373; Depreciation of \$807,322; and Taxes Other Than Income of \$56,345.³

3. In its amended application, Henry District proposes to increase test period Operation and Maintenance Expenses by \$29,906 for salaries and wages and by \$36,650⁴ for purchased power costs based on its proposed annual budget for 2009.⁵ As proposed adjustments to a historic test period that are based solely on budgeted information are not known and measureable and may not be considered in determining a utility's revenue requirement, the proposed adjustments to test period Operation and Maintenance Expenses should be rejected.⁶

4. In its amended application, Henry District proposes to decrease test period Plant Wellfield Repairs expenses by \$50,000⁷ to remove a one-time, non-

³ *Annual Report of Henry County Water District No. 2 to the Public Service Commission for the Calendar Year Ended December 31, 2008* at 20.

⁴ Amended Application, Exhibit 4 at 3.

⁵ Henry District's Response to Commission Staff's Second Set of Information Requests, Item 41.

⁶ 807 KAR 5:001, Section 10.

⁷ Amended Application, Exhibit 4 at 3.

recurring expense for a major repair.⁸ The proposed removal of this non-recurring expense from test period operations is consistent with generally accepted ratemaking practices and should be accepted.

5. In its amended application, Henry District reported test period Contract Engineering expenses of \$31,402⁹ but subsequently stipulated that these expenses were improperly classified, should have been reported as a capital asset, and should be removed from test period year Operation and Maintenance Expenses.

6. a. Henry District has calculated its test period depreciation expense related to its water transmission and distribution mains using a 25-year depreciable life or a 33-year depreciable life.¹⁰

b. Henry District has calculated its test period depreciation expense for meters and meter installations using a 10-year depreciable life.

c. Generally, water transmission and distribution mains of small water systems should be depreciated over a period from 50 years to 75 years.¹¹

d. Generally, a small water system's meters and meter installations should be depreciated over a period from 40 years to 50 years.¹²

e. In establishing test period depreciation expense, Henry District has understated the useful lives of its water transmission and distribution mains and its meters and meter installations.

⁸ Henry District's Response to Commission Staff's First Information Request, Item 4, General Ledger Account 675-7 – Plant & Well Field Repair.

⁹ Amended Application, Exhibit 4, Page 3.

¹⁰ Henry's Response to Commission Staff's Third Information Request, Item 1.

¹¹ See National Association of Utility Regulatory Commissioners, *Depreciation Practices for Small Water Utilities* (Aug. 15, 1979) at 11.

¹² *Id.*

f. Assuming a 50-year depreciable life for Henry District's water transmission and distribution mains and a 40-year depreciable life for its meter and meter installation, Henry District's test period depreciation expense should be \$645,650 or approximately \$161,672 less than Henry District reported for the test period.

7. Henry District's abbreviated pro forma operating statement for the test period is shown in Table 1 below.

TABLE 1			
	Test Year	Adjustments	Pro forma
Operating Revenues			
Water Sales	\$2,879,514		\$2,879,514
Other Operating Revenue	<u>121,540</u>		<u>121,540</u>
Total Operating Revenues	3,001,054		3,001,054
Operating Expenses			
Operation and Maintenance	2,005,373	¹³ (\$81,402)	1,923,971
Depreciation	807,322	(161,672)	645,650
Taxes Other Than Income	<u>56,345</u>		<u>56,345</u>
Total Operating Expenses	2,869,040	(243,074)	2,625,966
Net Operating Income	132,014	243,074	375,088
Plus: Interest Income	<u>111,787</u>		<u>111,787</u>
Income Available to Service Debt at Present Rates	<u>\$ 243,801</u>	<u>\$243,074</u>	<u>\$ 486,875</u>

¹³ Remove Filter Repair Costs
Remove Contracted Engineering Fees
Total

\$(50,000)
(31,402)
\$(81,402)

8. The average of Henry District's principal and interest payments for long-term debt for the next five years is \$819,110.¹⁴

9. Henry District's revenue requirement should be determined by the use of debt service coverage ratio of 1.2.¹⁵

10. To maintain a debt service coverage ratio of 1.2, Henry District must have annual income of \$982,932¹⁶ available for debt service.

11. Based upon its adjusted test period operations and assuming a debt service coverage ratio of 1.2, Henry District's total annual revenue requirement from water sales should be \$3,375,571.¹⁷

12. Henry District's current water service rates will not produce sufficient revenues to allow Henry District to meet its reasonable operating expenses and provide income to equal or exceed 120 percent of its debt service requirements.

¹⁴ See Raisor, Zapp & Woods, PSC, *Henry County Water District No. 1: Basic Financial statements, Supplemental Information, and Independent Auditors' Reports At December 2009 and 2008* (Mar. 25, 2010) at 17. The calculation of the five-year average appears below:

<u>Year</u>	<u>Principal and Interest</u>
2010	\$ 832,016
2011	827,272
2012	823,978
2013	822,326
2014	<u>789,959</u>
Total	<u>\$4,095,551</u>

Five-Year Average = \$4,095,551 ÷ 5 years = \$819,110.

¹⁵ Original Application, Exhibit 4 at 2.

¹⁶ Five-year average principal and interest payments	\$819,110
Times: 120 Percent Coverage Ratio	<u>120%</u>
Total Debt Service Requirement	<u>\$982,932</u>

¹⁷ Total Operating Expenses	\$2,625,966
Plus: Debt Service Requirement	982,932
Minus: Interest Income	(111,787)
Minus: Other Operating Revenue	<u>(121,540)</u>
Total Revenue Requirement From Water Sales	<u>\$3,375,571</u>

13. Henry District's rates for water service should produce an additional \$496,057¹⁸ in annual revenue to enable Henry District to meet its reasonable expenses and provide income to equal or exceed the 120 percent debt service coverage ratio.

14. The required revenue increase represents a 17.23 percent¹⁹ increase over pro forma present rate revenues.

15. The required revenue increase should be evenly distributed to Henry District's current rate design.

16. The rates set forth in Appendix A to this Order reflect an even distribution of the required revenue increase to Henry District's current rate design and, based upon test period water sales, will produce the required revenue.

17. When calculating and recording depreciation expense on such assets as distribution and transmission mains and meter installations in future reporting periods, Henry District should assign a depreciable life to such assets that is within the range that National Association of Utility Commissioners ("NARUC") specifies for small water utilities.²⁰

IT IS THEREFORE ORDERED that:

1. Henry District's proposed rates for water service are denied.
2. The rates set forth in Appendix A are approved for water service that Henry District provides on and after the date of this Order.

¹⁸ Debt Service Coverage	\$982,932
Less: Income Available to Service Debt at Present Rates	<u>(486,875)</u>
Required Revenue Increase	<u>\$496,057</u>

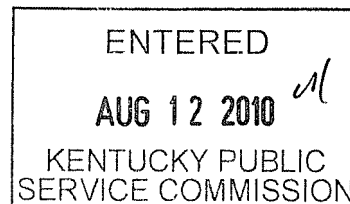
¹⁹ Required Revenue Increase	\$496,057
Divided by: Pro forma Present Rate Water Sales	<u>2,879,514</u>
Percentage of Increase to Present Revenues	<u>17.23%</u>

²⁰ See NARUC, *supra* note 2, at 11. See also Stipulation at ¶¶ 11-12.

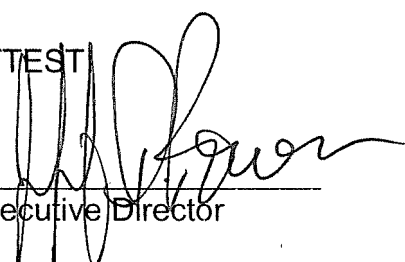
3. Within 30 days of the date of this Order, Henry District shall file with the Commission revised tariff sheets setting forth the rates approved in this Order.

4. When calculating and recording depreciation expense on such assets as distribution and transmission mains and meter installations in future reporting periods, Henry District shall assign a depreciable life to such assets that is within the range that NARUC specifies for small water utilities. Henry District is not required to calculate and report the cumulative effect of this action in accounting estimates for prior years.

By the Commission



ATTEST


Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2009-00370 DATED **AUG 12 2010**

The following rates and charges are prescribed for the customers in the area serviced by Henry County Water District No. 2. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

Monthly Water Rates

First	1,500 gallons	\$18.76 Minimum Bill
Next	3,500 gallons	6.74 per 1,000 gallons
Next	5,000 gallons	6.15 per 1,000 gallons
Next	10,000 gallons	4.98 per 1,000 gallons
Next	30,000 gallons	3.81 per 1,000 gallons
Over	50,000 gallons	2.58 per 1,000 gallons
Wholesale		\$2.58 per 1,000 gallons

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