

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF PENDLETON COUNTY WATER)
DISTRICT FOR AN ADJUSTMENT IN RATES) CASE NO. 2012-00413
PURSUANT TO THE ALTERNATIVE RATE FILING)
PROCEDURE FOR SMALL UTILITIES)

ORDER

Pendleton County Water District ("Pendleton District") has applied for an adjustment of its rates for water service. By this Order, the Commission establishes rates that will produce annual revenues from water sales of \$1,338,993, an increase of 10.1 percent over revenues of pro forma present-rate revenues from water sales of \$1,215,999. This rate adjustment will increase the bill of a customer who uses 5,000 gallons of water monthly from \$46.85 to \$51.58 monthly, or 10.1 percent.

On September 10, 2012, Pendleton District applied for a rate adjustment pursuant to 807 KAR 5:076. After reviewing the application and Pendleton District's records, Commission Staff on October 29, 2012 issued a report containing its findings and recommendations regarding the proposed rate adjustment. Commission Staff recommended approval of Pendleton District's proposed rates.¹ It further recommended that the Commission direct Pendleton District to revise its method for calculating and recording depreciation expense of water mains for accounting and

¹ Commission Staff Report on Pendleton County Water District ("Commission Staff Report") at 3 (filed Oct. 29, 2012).

ratemaking purposes.² In its response to this report, Pendleton District on November 2, 2012 advised the Commission in writing that “the case be submitted based on the existing record as it stands without a hearing.”³ It did not object to any of Commission Staff’s findings or recommendations. On November 16, 2012, the Commission closed the record and declared the case submitted for decision.⁴

Having reviewed the evidence of record and being otherwise sufficiently advised, the Commission finds that:

1. Except where they conflict with the findings contained in the Order, the findings contained in Commission Staff’s report are supported by the evidence of record, are reasonable and should be adopted.
2. Pendleton District is a water district organized pursuant to KRS Chapter 74.
3. Pendleton District owns and operates facilities that distribute water to approximately 2,244 customers in Campbell, Grant, and Pendleton counties, Kentucky.⁵
4. The calendar year ending December 31, 2011 should be used as the test period to determine the reasonableness of Pendleton District’s existing and proposed rates.

² Commission Staff Report Attach. A at 10.

³ Letter from William Jones, Manager, Pendleton County Water District, to Jeff Derouen, Executive Director, Public Service Commission (filed on Nov. 5, 2012)

⁴ Pendleton District is the only party to this proceeding. No persons have sought to intervene in this proceeding.

⁵ *Annual report of Pendleton County Water District to the Public Service Commission for the Calendar Year Ended December 31, 2011* (“2011 Annual Report”) at 5 and 27.

5. Based upon pro forma test-period operations, Pendleton District's pro forma annual revenue from Water Sales, Other Operating Revenues and Interest Income is \$1,263,002.⁶ Approximately \$1,215,999 of this revenue is from water sales.

6. The statement of Pendleton District's test-period operations, as adjusted for known and measurable changes, is set forth at Appendix A of this Order.

7. Based upon pro forma test-period operations, Pendleton District's pro forma total operating expenses, after adjusting for known and measurable changes, are \$1,267,753.

8. Pendleton District reported test-period depreciation expense of \$348,712.⁷ Of this amount, \$231,709 was related to transmission and distribution mains.⁸

9. Pendleton District has assigned a 40-year service life to transmission and distribution mains, but has provided no evidence in support of this assigned service life.

10. The Commission has previously used the results of the survey by the National Association of Regulatory Utility Commissioners ("NARUC") that contained "a range of average service lives currently being used by water utilities throughout the

⁶ \$1,215,999 (Water Sales) + \$37,540 (Other Operating Revenues) + \$9,463 (Interest Income) = \$1,263,002. See Commission Staff Report Attach. A at 6; *Annual Report* at 11, 27.

⁷ App. Ex. 6.

⁸ App. Ex. 9 at 15.

country for water facilities designed and installed and maintained in accordance with good water works practice⁹ to establish the service lives of utility assets.¹⁰

11. The NARUC Survey indicates that the service life range for a transmission or distribution main is between 50 and 75 years.¹¹

12. The service life that Pendleton District has assigned to transmission and distribution mains is not reflective of the actual life of such assets.

13. Given the materials of which Pendleton District's transmission and distribution mains are composed and the low incidence of water loss in Pendleton District's water system, the use of a 75-year service life for Pendleton District's transmission and distribution mains is appropriate and reasonable.

⁹ National Association of Regulatory Utility Commissioners, *Depreciation Practices for Small Water Utilities* (Aug. 15, 1979) at 10.

¹⁰ See, e.g., Case No. 2009-00370, *Application of Henry County Water District No. 2 for Approval to Adjust Water Rates and Charges, Construct and Finance a Proposed Waterworks Project and Implement a System Development Charge* (Ky. PSC Aug. 12, 2010); Case No. 2006-00398, *Application of Northern Kentucky Water District for Approval of Depreciation Study* (Ky. PSC Nov. 21, 2007); Case No. 2001-00472, *Proposed Adjustment of the Wholesale Water Service Rate of the City of West Liberty, Kentucky* (Ky. PSC Sept. 30, 2002). The Commission has also adopted Commission Staff recommendations concerning service lives that were based upon this survey. See, e.g., Case No. 2008-00057, *Application of the Grayson County Water District for Approval of a Proposed Increase in Rates for Water Service* (Ky. PSC Oct. 21, 2008); Case No. 2003-00401, *Application of the Lake Village Water Association, Inc., for Approval of a Proposed Increase in Rates for Water Service* (Ky. PSC Feb. 2, 2004); Case No. 92-007, *The Application of Levee Road Water Association, Inc. for a Rate Adjustment Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC July 10, 1992). The Commission's use of the NARUC survey to determine service lives does not preclude the use of other surveys of the average lifetimes for the major water and wastewater system components. See, e.g., Commission on Rural Water, *Guide for the Support of Rural Water-Wastewater Systems* (Chicago, Ill. 1974) (cited favorably by the Commission in Case No. 2004-00336, *Joint Application of B & H, Inc. and Richmond Utilities, LLC for Approval of the Transfer of Wastewater Treatment Plant to Richmond Utilities, LLC* (Ky. PSC Dec. 22, 2004).

¹¹ *Depreciation Practices for Small Water Utilities* at 11.

14. Assigning a 75-year service life to Pendleton District's transmission and distribution mains results in a reduction of \$108,113 in Pendleton District's test-period depreciation expense.¹²

15. Pendleton District's long-term creditors, the average annual principal and interest payment for the five-year period from 2012 through 2014 on the outstanding Pendleton District debt that each creditor holds, and the debt service coverage requirement of each creditor is shown in Table 1.

TABLE 1		
Creditor	Average Annual Principal & Interest Payment (2012-2014)	Debt Service Coverage Ratio
Rural Development	\$102,726	1.20
Kentucky Rural Water Finance Corp	\$ 28,372	1.20
Kentucky Association of Counties	\$ 8,797	1.00

16. Given that Pendleton District is a water district, the use of the debt service coverage methodology to calculate its revenue requirement is appropriate and consistent with the Commission's historic ratemaking practices.¹³

17. Applying the debt service coverage requirements to Pendleton District's average principal and interest payments for the years 2012 through 2014 results in an

¹² Depreciable Basis in Mains	\$9,269,717
Divide by: 75-year Service Live	<u>+75</u>
Pro forma Depreciation for Mains	123,596
Less: Test-Period Depreciation for Mains	<u>(231,709)</u>
Decrease	<u>(108,113)</u>

The Commission has made additional adjustments to test-period depreciation expense to reflect the annualization of depreciation taken on assets placed into service during the test period, to recognize depreciation expense on a main relocation, to increase depreciation expense on certain replacement assets to reflect losses due to the retirement of assets, and to remove depreciation on assets that were fully depreciated at the end of the test period.

¹³ Pendleton District proposed the use of this methodology to determine its revenue requirement. App. Ex. 7.

annual revenue requirement from water sales of \$1,384,907, or \$168,908 more than the pro forma annual revenue from Pendleton District's present rates.¹⁴

18. Based upon pro forma test-period sales, Pendleton District's proposed rates would produce annual revenue of \$1,338,984.

19. The annual revenue produced from Pendleton District's proposed rates is \$45,923 less than the level of revenue deemed reasonable using the debt service methodology.

20. Pendleton District's proposed rates will produce sufficient revenues for Pendleton District to remain in compliance with all outstanding debt instrument obligations.¹⁵

21. The record contains no evidence that permitting Pendleton District to assess its proposed rates will result in any degradation or reduction in the quality of service that Pendleton District currently provides.

22. A utility may propose rates that fail to produce a level of revenues that accepted ratemaking methodologies would regard as insufficient or inadequate. Absent

¹⁴ Pro Forma Operating Expenses	\$1,267,753
Add: Three-Year Average Debt Service	139,895
Debt Service Coverage	<u>24,262</u>
Total Revenue Requirement	1,431,910
Less: Other Operating Income	(37,540)
Interest Income	<u>(9,463)</u>
Revenue Required From Water Sales	1,384,907
Less: Pro Forma Present Rate Water Sales	<u>(1,215,999)</u>
Required Revenue Increase	<u>\$ 168,908</u>

See Commission Staff Report Attach. A at 1.

¹⁵ Commission Staff Report Attach. A at 3-4. Our review of Pendleton District's debt instruments indicate that those that require a debt service coverage generally require that rates produce annual net revenues equal to at least 120 percent of the average annual debt service requirements for principal and interest on all Outstanding Bonds. Net revenue is defined as gross revenues less operating expenses. Depreciation is not considered an operating expense. As such net revenue for the purpose of calculating compliance with the provisions of a bond ordinance or other debt instrument is much larger than when depreciation expense is considered.

evidence that the quality of the utility's service will decline or be degraded as a result of this level of revenue, the proposed rates should be accepted.¹⁶

23. Pendleton District's proposed rates should be approved for service rendered on and after the date of this Order.

24. Commission Staff has recommended that the Commission require Pendleton District to assign a service life of 75 years to transmission and distribution mains and to use that service life for both ratemaking and accounting purposes when calculating and reporting depreciation expense.

25. As Pendleton District has not objected to Commission Staff's recommendation, as the proposed service life is within the range set forth by the NARUC study, and as a single approach to ratemaking and general accounting treatment of this issue will avoid confusion and incorrect reporting, Commission Staff's recommendation should be implemented.

26. Commission Staff's recommended action has implications beyond this rate case proceeding. Absent a showing of a change in circumstances, it will require the use of this service life in future rate case proceedings. It may also affect Pendleton District's financial statements and reports to all governmental authorities, financial institutions, and lenders. Should Pendleton District upon further consideration find that it does not agree with the implementation of Commission Staff's recommendation, it should

¹⁶ *Utilities Operating Co. v King*, 143 So.2d 854, 45 PUR3d 439, 443 (Fla. 1962) ("[I]n the absence of some showing that the service to the public will suffer by allowing . . . [a] utility to charge rates which will not produce a fair return, the utility and not the Commission has the right of decision as to the rates it will charge so long as they do not exceed those which would produce a fair return as determined by the Commission."). See also Case No. 2006-00410, *The Application of Hardin County Water District No. 1 for a General Rate Adjustment Effective On and After December 2, 2006* (Ky. PSC Aug. 2, 2007); Case No. 98-398, *Adjustment of Rates of the Kentucky Turnpike Water District and the Imposition of an Impact Fee* (Ky. PSC June 30, 1999).

exercise its right pursuant to KRS 278.400 to petition the Commission for rehearing within 20 days of the date of this Order.

IT IS THEREFORE ORDERED that:

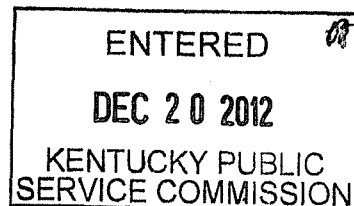
1. Except where they contradict or conflict with the findings contained in this Order, the findings contained in the Commission Staff's report are adopted and incorporated by reference into this Order as if fully set out herein.

2. The rates set forth in Appendix B to this Order are approved for water service that Pendleton District renders on and after the date of this Order.

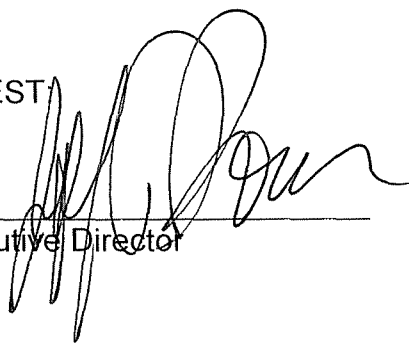
3. Within 20 days of the date of this Order, Pendleton District shall file revised tariff sheets with the Commission setting forth the rates approved in this Order.

4. Pendleton District shall for accounting and ratemaking purposes use a service life of 75 years for transmission and distribution mains when calculating and reporting depreciation for all reporting periods after the date of this Order, but shall make no retroactive adjustment to its books to account for the cumulative effect of this change in accounting estimate.

By the Commission



ATTEST



Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2012-00413 DATED **DEC 20 2012**

Pendleton County Water District Adjusted Operating Statement

Account Titles	Test-Period Operations	Pro Forma	
		Adjustments	Operations
Operating Revenues			
Water Sales	\$ 1,202,507	\$ 13,492	\$ 1,215,999
Other Operating Revenues:	37,540		37,540
Total Operating Revenues	\$ 1,240,047	\$ 13,492	\$ 1,253,539
Operating Expenses			
Operation & Maintenance:			
Salaries & Wages – Employees	297,298		297,298
Salaries & Wages – Officers	23,600		23,600
Employee Pension & Benefits	93,098		93,098
Purchased Water	403,943	9,090	413,033
Purchased Power	19,472		19,472
Materials & Supplies	83,709	(37,343)	46,366
Contractual Services – Accounting	18,600		18,600
Contractual Services – Testing	1,185		1,185
Contractual Services – Other	35,617	(2,560)	33,057
Equipment Rental	2,425		2,425
Transportation Expense	21,876		21,876
Insurance - Vehicle	6,182		6,182
Insurance – General Liability	10,087		10,087
Insurance – Worker's Comp	4,618		4,618
Insurance - Other	1,209		1,209
Advertising	1,166		1,166
Bad Debt Expense	4,632		4,632
Miscellaneous	2,983	(848)	2,135
Total Operation & Maintenance	1,031,700	(31,661)	1,000,039
Depreciation	348,712	(105,742)	242,970
Taxes Other Income	24,744		24,744
Total Operating Expenses	\$ 1,405,156	\$ (137,403)	\$ 1,267,753
Net Operating Income	(165,109)	\$ 150,895	\$ (14,214)
Other Income & Deductions:			
Interest Income	9,463		9,463
Loss on Disposition of Property	(50,498)	50,498	0
Net Income Available for Debt Service	\$ (206,144)	\$ 201,393	\$ (4,751)

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2012-00413 DATED DEC 20 2012

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

Monthly Water Rates

5/8 x 3/4-Inch through 2-Inch Meter

First	2,000 gallons	\$22.45	Minimum bill
Next	3,000 gallons	9.71	per 1,000 gallons
Next	10,000 gallons	9.16	per 1,000 gallons
All Over	15,000 gallons	7.95	per 1,000 gallons

Pendleton County High School

First	125,000 gallons	\$1,018.00	Minimum bill
All Over	125,000 gallons	7.95	per 1,000 gallons

Griffin Industries

First	400,000 gallons	\$3,232.80	Minimum bill
All Over	400,000 gallons	7.95	per 1,000 gallons

City of Butler

First	1,672,917 gallons	\$6,500.95	Minimum bill
All Over	1,672,917 gallons	3.88	per 1,000 gallons

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