Ernie Fletcher Governor

Teresa J. Hill, Secretary Environmental and Public Protection Cabinet

Timothy J. LeDonne Commissioner Department of Public Protection

Honorable John N. Hughes Attorney at Law 124 West Todd Street Frankfort, KY 40601



Commonwealth of Kentucky
Public Service Commission

211 Sower Blvd. P.O. Box 615 Frankfort, Kentucky 40602-0615 Telephone: (502) 564-3940 Fax: (502) 564-3460 psc.ky.gov

November 21, 2007

Mark David Goss Chairman

> John W. Clay Vice Chairman

Caroline Pitt Clark Commissioner

CERTIFICATE OF SERVICE

RE: Case No. 2006-00398 Northern Kentucky Water District

I, Beth O'Donnell, Executive Director of the Public Service Commission, hereby certify that the enclosed attested copy of the Commission's Order in the above case was served upon the addressee by U.S. Mail on November 21, 2007.

Executive Director

BOD/rs Enclosure



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Timothy J. LeDonne

Commissioner Department of Public Protection

Frankfort, KY 40601-8204

November 21, 2007 Honorable David Edward Spenard Assistant Attorney General Office of the Attorney General Utility & Rate Intervention Division 1024 Capital Center Drive Suite 200



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Honorable John N. Hughes Attorney at Law 124 West Todd Street Frankfort, KY 40601 Honorable David Edward Spenard Assistant Attorney General Office of the Attorney General Utility & Rate Intervention Division 1024 Capital Center Drive Suite 200 Frankfort, KY 40601-8204

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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APPLICATION OF NORTHERN)	
KENTUCKY WATER DISTRICT)	CASE NO.
FOR APPROVAL OF DEPRECIATION)	2006-00398
STUDY)	

ORDER

In Case No. 2002-00105,¹ the Commission, recognizing the importance of adequate depreciation recovery to fund renewals and replacements of plant assets,² ordered Northern Kentucky Water District ("Northern") to perform a depreciation study.³ In response to the Commission's Order, on August 31, 2006, Northern submitted a depreciation study prepared by Black & Veatch ("Original Study"). The Original Study was accepted by the Commission for review.

Upon request, intervention was granted to the Attorney General of the Commonwealth of Kentucky ("Attorney General") by Order dated September 19, 2006.

The Original Study is not a traditional depreciation study. The end result of any depreciation study is to determine the estimated useful lives over which the cost of plant assets should be recognized. Traditional depreciation studies analyze a utility's historic

¹ Case No. 2002-00105, Application of Northern Kentucky Water District for (A) an Adjustment of Rates; (B) a Certificate of Public Convenience and Necessity for Improvements to Water Facilities if Necessary; and (C) Issuance of Bonds.

² The Kentucky Supreme Court found in *Public Service Comm'n v. Dewitt Water District, et al.*, 720 S.W.2d 725 (Ky. App. 1986) that that depreciation for a water district, a non-profit utility, is an operating expense included in the calculation of rates for service to provide funds for renewals and replacement of assets.

³ April 30, 2003 Order at 18 and 29.

plant addition and retirement information to determine anticipated service lives. Black and Veatch state that at least 30 years of specific plant addition and retirement information must be available to perform a reliable analysis.⁴ Northern does not possess the required information. Northern was formed on January 1, 1997 from the merger of Kenton County Water District No. 1 and Campbell County Kentucky Water District.⁵ Northern began maintaining the plant addition and retirement records necessary to perform a proper analysis in 1999.⁶ Detailed records do not exist prior to this date.

In the absence of the required information, benchmarking was relied upon to establish the depreciation rates recommended in the Original Study. Black and Veatch's benchmarking analysis included the depreciation practices and methods of 17 regional water utilities. From this proxy, Black & Veatch developed average trends to determine the recommended depreciation rates. Deviation from the average trends was incorporated in the study where circumstances specific to Northern warranted adjustment.

An informal conference was held on January 25, 2007 to discuss the Original Study. At the conference the following concerns were discussed:

 the Original Study did not identify characteristics common to the proxy group and Northern;

⁴ Original Study at 11.

⁵ <u>See</u> Case No. 1996-00234, The Joint Application of Kenton County Water District No. 1 and Campbell County Kentucky Water District for Authority to Merge into Northern Kentucky Water Service District and for Authority for the Combined District to Operation (August 22, 1996).

⁶ Original Study at 11.

- 2. the Original Study did not identify the method of determining depreciation rates used by each of the utilities included in the proxy group; and
 - 3. the proxy group only included two Kentucky water suppliers.

Addressing these concerns, Northern filed a revised depreciation study prepared by Black & Veatch ("Revised Study") on October 24, 2007. Table I highlights the details of the Original Study and the Revised Study.

	Table I	
	Original	Revised
Test Year Analyzed	2004	2004
Test Year Depreciation Expense	\$5,128,169	\$5,128,169
Increase	2,190,986	1,808,037
Adjusted Depreciation Expense	7,319,155	6,936,206
Overall Composite Rate	3.04	2.88
Salvage Value Included	No	Yes
Method	Straight-Line,	Straight-Line
	Remaining Life	Whole Life
Proxy Group	Indiana 5	Kentucky 4
·	Kentucky 2	Average Service Lives
	Ohio 5	used by the Florida
	Missouri 5	Public Service
		Commission

Through a filing received on October 25, 2007, the Attorney General stated he had no objection to the Revised Study.

Due to the detailed information and expense required to perform a traditional depreciation study using generally accepted practices, no water district operating under the Commission's jurisdiction has ever filed such a study for Commission review. The absence of such study does not prevent Commission review of depreciation practices of those utilities. Historically, the Commission has relied on the National Association of

Regulatory Utility Commissioners ("NARUC") Study of Depreciation Practices for Small ⁷ Water Utilities ("NARUC Study"), dated August 15, 1979, to judge the reasonableness of a utility's depreciation practices. The NARUC Study outlines expected life ranges for asset groups. An adjustment is made when the Commission finds that a utility is using a life that falls outside of this range. ⁸

Table II compares Northern's current depreciable lives, the lives proposed in the Original Study and Revised Study, and those of the NARUC Study.

	Tab	ole II		
		Original	Revised	NARUC
(Current	Study	Study	Study
Structures and Improvements	59	31	39	35-40
Lakes and Rivers	22	48	43	35-45
Supply Mains	99	72	38	50-75
Pumping Equipment	29	29	49	20
Water Treatment Equipment	46	29	50	20-40
Dist. Reservoirs and Standpipes	57	40	43	30-60
Trans. and Dist. Mains	94	50	50	50-75
Services	49	44	40	30-50
Meters and Meter Installations	43	26	40	35-50
Hydrants	50	40	48	40-60
Other Plant and Misc. Equip.	9	11	8	
Office Furniture and Equip.	8	11	15	20-25
Computer Equipment	4	5	5	
Transportation Equipment	5	9	5	7
Stores Equipment	5 .	25	18	20
Tools, Shop, and Garage Equip.	3	17	10	15-20
Power Operated Equip.	5	14	10	10-15
Communication Equip.	11	15	8	10
Miscellaneous	8	16	18	

⁷ While the title of the publication is "Depreciation Practices for Small Water Utilities," the publication finds that "the small water utility average service lives and depreciation rates would be similar to those used by the average water utility." <u>See</u> NARUC Study at iv. The findings of the publication can then also be applied to the "average water utility" in developing standard depreciation practices.

⁸ A recent example of the Commission's application of the findings of the NARUC Study can be found in Case No. 2006-00542, Application of West McCracken County Water District for Approval of a Proposed Increase in Rates for Water Service, to Increase Non-Recurring Charges, and to Revise its Tariff Accordingly.

Given the large differences in the results of the Original Study and Revised Study for certain asset groups, e.g., Supply Mains, the Commission questions the validity and reasonableness of their findings and conclusions. Further, the recommended lives assigned to certain asset groups in these studies fall outside the recommendations of the NARUC Study. For these reasons the Commission finds both the Original Study and Revised Study to be inappropriate and should be denied.

Considering that the current lives assigned to certain asset groups fall outside of the NARUC Study's recommendations, the Commission finds that Northern's current depreciation rates warrant adjustment. To maintain consistent application of depreciation practices for water utilities where traditional depreciation studies are not performed, the Commission finds that Northern shall be allowed to adjust its current depreciation rates based on the average life range for each asset group found appropriate in the NARUC Study.

Where the NARUC Study makes no recommendation for Northern's asset groups as listed in Table II, the Commission finds that the depreciable life recommended in the Revised Study should be utilized. Considering the low balances of these accounts relative to total plant and the difference in their current lives and those lives recommended in the Revised Study, the Commission's findings and resulting adjustments are of no significant consequence.

The Original Study gave no consideration to salvage but salvage was included in the Revised Study. It is common practice to account for salvage in the calculation of depreciation. The salvage allowances included in the revised study are based upon Northern's practices.⁹ The Commission finds that the depreciation rates approved

⁹ See Revised Study, Table 6, at 3 of 3.

herein shall include the salvage allowances included in the Revised Study. Northern shall track the recovery of asset removal costs included in the salvage allowances separately and charge this recovery to account 253.1, Other Deferred Credits-Regulatory Liabilities. The balance of this account shall be reclassified to accumulated depreciation when determining future depreciation rates.

The Original Study calculated depreciation using the straight-line remaining life method while the straight-line whole life method was used in the Revised Study. The Commission found no explanation for the change of method in the record. The Commission has calculated Northern's 2004 depreciation using both methods based upon the Commission's findings herein. Using the whole life method, the Commission determined Northern's 2004 annual depreciation to be \$6,755,967, an overall composite rate of 2.81 percent, while the annual expense using the remaining life method is \$7,088,371, an overall composite rate of 2.94. The calculations using the whole life and remaining life methods are shown in this Order at Appendices A and B, respectively.

The NARUC Uniform System of Accounts ("USoA"), as adopted by the Commission, allows for use of either the Straight-Line Method (Whole Life Method) or the Straight-Line Remaining Life Method depending upon Commission approval. ¹⁰ The Commission has no preference as to which method Northern employs. Since Northern's most recent request, the Revised Study, uses the Whole Life Method, the Commission finds that this method shall be approved. The Commission further finds that Northern shall have the opportunity to request use of the Remaining Life Method.

¹⁰ See USoA for Class A/B Water Districts and Associations, Accounting Instruction 33, at 35.

IT IS THEREFORE ORDERED that:

- The composite depreciation rates requested in the Original Study and Revised Study are denied.
- 2. The composite depreciation rates for each account group of Northern's plant assets as shown in Appendix A of this Order are approved and effective as of the date of this Order unless Northern notifies the Commission of its wish to instead be allowed the composite rates shown in Appendix B of this Order. If Northern timely files its written request for the composite rates shown in Appendix B, the composite depreciation rates for each account group of Northern's plant assets as shown in Appendix B are approved and effective as of the date of this Order with no further rulings required of the Commission.
- 3. Any request by Northern for the composite rates shown in Appendix B must received by the Commission within 10 days from the date of this Order.
- 4. Northern shall properly account for recovery of non-legal asset removal costs as a regulatory liability.

Done at Frankfort, Kentucky, this 21st day of November, 2007.

By Commission

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2006-00398 DATED NOVEMBER 21, 2007

Overall Composite Depreciation Rate	Divide by: Original Cost of Depreciable Plant	Total	Miscellaneous	Communication Equipment	Power Operated Equipment	Stores Equipment	Transportation Equipment	Computer Equipment	Office Furniture and Equipment	Other Plant and Misc. Equip.	Hydrants	Weters and Weter Installations	Oervices	Conicco	Tone Diet Mains	Dietr Deservoirs and Standnine	Water Treatment Equipment	Dimping Equipment	Simply Mains	lakes and Rivers	Structures and Improvements	Land		Whole Life Depreciation	
Rate	eciable Plant	\$ 241,419,277	593,361	297,716	529,499	13,051	2,512,074	918,944	1,433,584	3,374,076	4,550,642	0,007,000	6 737 668	18 787 274	106 184.511	7.500.741	9.285.428	8.661.832	2.307,853	1,524,592	65,516,439	\$ 605,416	1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1	Original Cost	
	,	\$		-10%	-15%	- 1 - 70	-10%	400/			0/ 0.7	35%	10%	5%	5%	30%	15%	15%	10%		13% \$		(Cost/ (Salvage) Percent	-
		21,129,118	t	(29,772)	(79,425)	(0010.0)	(39.813)	(152 173)	i 1		.,	1 137 711	653.767	939,364	5,309,226	2,250,222	1,392,814	1,299,275	230,785	ŧ	8,517,137 \$			Removal Cost/ (Salvage) Dollars	
		\$ 261,942,979	593,361	267,944	450,074	13,051	244,563	2 059 901	918.944	1 433 584	3 374 076	5,688,553	7,191,435	19,726,638	111,493,737	9,750,963	10,678,242	9,961,107	2,538,638	1,524,592				Total to be Recovered	
II.		ï	- 0.C	10.0	12.5	17.5	20.0	7.0	ა ნ.0	22.5	8.0	50.0	42.5	40.0	62.5	45.0	30.0	20.0	62.5	40.0 1	37.50 40.00			Whole	
2.81%	240,013,001	6,755,967	02,000	32 085	36,006 36,794	746	12,228	294,272	183,789	63,715	421,760	113,771	169,210	493,166	1,783,900	216,688	355,947	498,055	40,616	40,10	277 00	4 074 220		Total Recovery	
**	•			5.556%	6.800% 9.000%	5.714%	4.300%	11.714%	20.000%	4.444%	12.500%	2.500%	2.588%	2.525%	1.680%	2.889%	3.033%	0.700%	1.500/c	4 760%	2.500%	3 013%		Composite Rate	

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2006-00398 DATED NOVEMBER 21, 2007

Divide by: Original Cost of Depreciable Ham	Total	Land Structures and Improvements Lakes and Rivers Supply Mains Pumping Equipment Water Treatment Equipment Distr. Reservoirs and Standpipes Trans. Dist. Mains Services Meters and Meter Installations Hydrants Other Plant and Misc. Equip. Office Furniture and Equipment Computer Equipment Transportation Equipment Stores Equipment Tools, Shop and Garage Equipment Communication Equipment Communication Equipment Miscellaneous	Remaining Life Depreciation
	\$ 241,419,277	\$ 605,416 65,516,439 1,524,592 2,307,853 8,661,832 9,285,428 7,500,741 106,184,511 18,787,274 6,537,668 4,550,842 3,374,076 1,433,584 918,944 2,512,074 284,376 13,051 593,361	Original Cost 12/31/2004
	\$ 48,288,710	\$ 11,350,180 601,663 339,413 3,408,410 2,717,678 2,542,408 12,557,965 5,832,870 1,143,635 1,065,870 690,381 1,833,191 273,713 2,503 395,978 257,541 591,642	Accumlated 12/31/2004
	\$ 193,130,567	\$ 605,416 54,166,259 922,929 1,968,440 5,253,422 6,567,750 4,958,333 93,626,546 12,954,404 5,047,248 3,357,593 2,230,441 367,714 228,563 10,548 13,521 40,175 1,719	Net Original Cost (To Be Recovered
	ų.	13% \$ 10% 15% 15% 30% 5% 5% -18% -18% -18% -10%	Removal Cost/ (Salvage) Percent of Cost
	\$ 21,129,118	8,517,137 230,785 1,299,275 1,392,814 2,250,222 5,309,226 939,364 653,767 1,137,711 (452,173) (452,173) (39,813) (79,425) (29,772)	Removal Cost/ (Salvage) Dollars
	\$ 214,259,685	605,416 62,683,396 922,929 2,199,225 6,552,697 7,960,564 7,208,555 98,935,772 13,893,768 5,701,015 4,495,304 2,230,441 367,714 2226,710 (29,150) 10,548 54,096 10,403 1,719	Total to be Recovered
	11	37.5 40.0 62.5 20.0 30.0 45.0 62.5 50.0 8.0 22.5 50.0 17.6 12.5	Whole 1
		8.90 9.87 15.80 9.43 10.55 17.35 8.72 11.47 5.82 14.06 3.29 9.91 0.06 8.58 8.58	Less: Existing ble Weighted R e Age
		28.600 \$ 30.130 46.700 10.570 19.450 27.650 53.780 28.530 36.680 35.940 4.710 16.690 0.960 1.310 10.090 17.437 3.920 3.080 7.240	Remaining Life
2.94%	240,813,861	\$ 2,191,727 30,632 47,093 619,933 409,284 260,707 1,839,639 486,988 155,426 125,078 473,554 22,032 238,086 173,061 (2,889) 605 13,800 3,378 237	Total (Recovery
llo,	į	3.345% 2.009% 2.041% 7.157% 4.408% 3.476% 1.732% 2.592% 2.377% 2.748% 14.035% 4.635% 4.635% 2.606% 1.135%	Composite Rate

Overall Composite Depreciation Rate