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Mark David Goss
Chairman

John W. Clay
Commissioner

August 2, 2007

CERTIFICATE OF SERVICE

RE: Case No. 2006-00410
Hardin County Water District #1

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 August 2, 2007.

A handwritten signature in black ink, appearing to read "Beth O'Donnell", written over a horizontal line.

Executive Director

BOD/tw
Enclosure



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COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF HARDIN COUNTY WATER)
DISTRICT NO. 1 FOR A GENERAL RATE) CASE NO.
ADJUSTMENT EFFECTIVE ON AND AFTER) 2006-00410
DECEMBER 2, 2006)

ORDER

Hardin County Water District No. 1 ("Hardin District") has applied for a rate adjustment that would generate annual revenues of \$3,643,056, which is an approximate 14.97 percent increase or \$474,326 above its pro forma operating revenues from water rates of \$3,168,730.¹ By this Order, we grant Hardin District's requested rate relief.

BACKGROUND

Hardin District, a water district organized pursuant to KRS Chapter 74, is a utility subject to Commission jurisdiction. KRS 278.010(3)(d); KRS 278.015; KRS 278.040. It provides retail water service to 9,400 customers in Hardin, Breckinridge, and Meade counties, Kentucky and wholesale water service to Meade County Water District ("Meade District"), Hardin County Water District No. 2 ("Hardin No. 2"), and the cities of Hardinsburg and Vine Grove.² Its territory primarily covers the city of Radcliff, Kentucky. Hardin District last applied for a rate adjustment in 2001.³

¹ Application, Exhibit 11, Revenue Requirement.

² Annual Report of Hardin District to the Public Service Commission of the Commonwealth of Kentucky for the Calendar Year Ended December 31, 2006 ("2006 Annual Report") at 5 and 30.

³ Case No. 2001-00211, Application of Hardin County Water District No. 1 for (1) Issuance of Certificate of Public Convenience and Necessity; (2) Authorization to Borrow Funds and to Issue its Evidence of Indebtedness Therefor; (3) Authority to Adjust Rates; and (4) Approval to Revise and Adjust Tariff (Ky. PSC March 1, 2002).

PROCEDURE

Hardin District submitted written notice of its intent to file an application for an adjustment of rates on September 15, 2006. It subsequently tendered its application on November 2, 2006. Because this application failed to comply with Administrative Regulation 807 KAR 5:001, Section 10, in several respects, the Commission rejected it for filing.

On November 11, 2006, Hardin District amended its application to correct these deficiencies. In the letter accompanying its supplemental filing, Hardin District stated that “[t]he effective date of the proposed rate and tariff adjustment has been changed to December 14, 2006.”⁴ Each of the revised tariff sheets included in the supplemental filing stated a “date of issue” of December 14, 2006, but did not state an effective date nor was it signed by an officer of the utility.⁵ Noting that Hardin District had failed to provide revised tariff sheets that state an effective date or include the signature of a utility officer,⁶ the Commission found that the district had not provided adequate notice and, therefore, could not place its proposed rates into effect on December 14, 2006. The Commission placed Hardin District on notice that, if it wished to place the proposed rates into effect prior to the conclusion of this proceeding, it must refile its proposed tariff

⁴ Letter from David T. Wilson II, counsel for Hardin County Water District No. 1, to Michael Burford, Director, Filings Division (Nov. 9, 2006).

⁵ The original tariff that Hardin District submitted also failed to state an effective date and was unsigned.

⁶ See Administrative Regulation 807 KAR 5:011, Section 3(5)(c) and (d); Section 4(4)(a); Section 6(4).

sheets with the Commission in accordance with KRS 278.180 and Administrative Regulation 807 KAR 5:011.

In its Order of December 16, 2006, the Commission found that, pursuant to KRS 278.190, further proceedings are necessary to determine the reasonableness of the proposed rate adjustment and that a procedural schedule should be established to ensure an orderly and expeditious review. The Attorney General of the Commonwealth of Kentucky ("AG") is the only intervenor in this proceeding.

On March 20, 2007, Hardin District moved to dispense with the procedural schedule and any public hearing and for submission of the case for a decision based upon the existing record. On April 13, 2007, the Commission granted the motion provided no party within 10 days objected or otherwise requested a hearing. No party subsequently requested a hearing or objected to the dispensing of the procedural schedule.

TEST PERIOD

Hardin District proposes to use the 12-month period ending December 31, 2005 as the test period to determine the reasonableness of its proposed rates. We find the use of this period is reasonable. In using a historic test period, the Commission gives full consideration to appropriate and known and measurable changes.

INCOME STATEMENT

For the test period, Hardin District reports actual operating revenues and expenses of \$3,644,599⁷ and \$2,664,268,⁸ respectively. Hardin District proposes several adjustments to revenues and expenses to reflect current and anticipated operating conditions, resulting in pro forma operating revenues of \$3,746,239⁹ and pro forma operating expenses of \$2,886,391.¹⁰ The Commission's review of these proposed adjustments is set forth below.

Operating Revenues - Water Sales

Hardin District reports test-period operating revenues from water sales of \$3,043,199.¹¹ The reported revenues from water sales are comprised of revenue from residential water sales of \$2,254,703, revenue from commercial water sales of \$275,136, revenue from multiple family dwellings of \$106,468, and revenue from wholesale water sales of \$406,892.¹²

⁷ Application, Exhibit 2, Audited Financial Statements for the Years Ended December 31, 2005 and 2004 at 9 of 41.

⁸ Application, Exhibit 11, Revenue Requirements. \$2,079,955 (Operating Expenses) + \$584,313 (Depreciation) = \$2,664,268.

⁹ \$3,644,599 (Actual Operating Revenues) + \$101,640 (Revenues from New Customers) = \$3,746,239.

¹⁰ Application, Exhibit 11, Revenue Requirements. \$2,197,027 (Pro Forma Operating Expenses) + \$689,364 (Pro Forma Depreciation) = \$2,886,391.

¹¹ Application, Exhibit 2, Audited Financial Statements for the Years Ended December 31, 2005 and 2004 at 9 of 41.

¹² Annual Report of Hardin District to the Public Service Commission of the Commonwealth of Kentucky for the Calendar Year Ended December 31, 2005 at 27.

Between January 1 and September 30, 2006, 263 new residential customers were added to Hardin District's system. Annualizing that value, Hardin District projects 350 new residential customers by the end of 2006.¹³ Applying an average customer usage of 5,000 gallons to the 350 projected residential customers, Hardin District calculates an increase in test-period revenues from water sales of \$101,640.¹⁴

In its 2006 Annual Report, Hardin District reports an actual end-of-period residential customer level of 8,809, an increase of 304 above the test-period level of 8,505.¹⁵ Using the actual residential customer increase of 304, and an average customer usage of 5,000 gallons, the Commission calculates an increase in test-period revenues from water sales of \$88,282. Since an adjustment to reflect the actual customer growth is known and measurable, the Commission finds that operating revenues should be increased by \$88,282.

Salaries and Wages – Employees

Hardin District proposes to increase test-year salaries and wages of \$843,039 by \$46,645 to a pro forma level of \$889,684. Table 1 below lists the components of Hardin District's pro forma adjustment:

¹³ Direct Testimony of Brent Tippey at 5.

¹⁴ In an earlier case, we denied a similar adjustment for expected customer growth as budgetary and not known and measurable. See 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 (Ky. PSC April 30, 2003) at 9-10.

¹⁵ 2006 Annual Report at 27.

Table 1	
<u>Description</u>	<u>Amount</u>
2006 Employee Wage Rate Increases	\$ 39,294
New Staff Accounting Position	45,142
New Customer Service Rep. Position	31,605
Annual Sewer Contract Fee	+ (69,396)
Pro Forma Adjustment	<u>\$ 46,645</u>

Hardin District multiplied the differences between the 2005 and 2006 employee wage rates by 2,080 annual hours to calculate the proposed wage rate increase of \$39,294.¹⁶ When Hardin District filed its application, the accounting position was filled and the actual salary, including estimates for the employee benefits, was \$45,142.¹⁷ According to Hardin District, the salary of \$31,605 for the customer service representative position is an estimate and the position will remain vacant until the rate increase is approved.¹⁸ Hardin District entered into a contract to operate the Fort Knox sewer operations for an annual fee of \$95,428.¹⁹ Because only \$26,032 of the Fort Knox sewer reimbursement was credited to its test-period operating expenses, Hardin District proposed to decrease salaries and wages expense by \$69,396 to reflect the annual reimbursement.

¹⁶ Application, Exhibit 5 at 5, Annualized Wage Increases.

¹⁷ Email from Karen Brown, Accounting Specialist, to Brent Tippey, Vice President, Quest Engineers (Oct. 19, 2006 10:39 AM).

¹⁸ Hardin District's Response to Commission Staff's Second Information Request, Item 22(c).

¹⁹ Id. at Item 23(b).

Using the updated payroll and wage information that reflects Hardin District's current staff level and 2007 employee wage rates, eliminating the capitalized wages, and reflecting the annual Fort Knox sewer operations fee of \$95,428, the Commission calculates a pro forma level of salaries and wages expense of \$942,823, an increase of \$99,784 above the test-period actual level of \$843,039. The Customer Service Representative position was not included in our calculation because an adjustment to reflect this position does not meet the rate-making criteria of being known and measurable. Accordingly, the Commission finds that Hardin District's proposed adjustment of \$46,645 should be denied and that salaries and wages expense - employees should be increased by \$99,784 to a pro forma level of \$942,823.

Employee Pensions and Benefits

Hardin District proposed to increase test-year employee pensions and benefits of \$322,231 by \$29,211 to a pro forma level of \$351,442. This adjustment reflects the new employee vision and dental coverage, the elimination of the health care insurance for the General Manager and Commissioners, and the July 1, 2006 County Employees Retirement System ("CERS") employer contribution rate increase to 13.19 percent.

On July 1, 2007, the CERS employer contribution rate increased from 13.91 percent to 16.17 percent.²⁰ Using the current employee insurance premiums, the monthly employee flexible spending allowance of \$117, eliminating the Commissioner

²⁰ Hardin District's Response to Commission Staff's Third Information Request, Item 12(b).

insurance benefits,²¹ using the employer retirement contribution rate of 16.17 percent, and FICA rate of 7.65 percent for salaries under \$97,500, the Commission calculates a pro forma level of employee pensions and benefits expense of \$382,459, an increase of \$60,228 above the test-period actual of \$322,231. Accordingly, the Commission finds that Hardin District's proposed adjustment of \$29,211 should be denied and that the employee pensions and benefits expense should be increased by \$60,228 to a pro forma level of \$382,459.

Purchased Water

Hardin District proposes to increase purchased water expense of \$24,638 by \$33,731 to a pro forma level of \$58,639. This adjustment reflects the effect of Hardin District's projected customer growth on future water purchases from Fort Knox.²² The actual increase in residential customers of 304 will require Hardin District to purchase an additional 18,240,000 gallons²³ from Fort Knox. Using additional water purchases of 18,240,000 gallons and a purchased water rate of \$1.60624 per 1,000 gallons,²⁴ the

²¹ In an earlier case, we found that District Commissioners would not qualify to receive comprehensive employee benefits because they generally meet only once a month and do not work a 40 hour work week. Therefore, these positions should be considered part-time employment. See Case No. 2003-00224, 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 (Ky. PSC June 14, 2004) at 11.

²² Direct Testimony of Brent Tippey at 9.

²³ 304 (Residential Customers) x 5,000 Gallons x 12 = 18,240,000 Gallons.

²⁴ \$33,731 (Hardin District's Pro Forma Adjustment) ÷ 21,000 (Annual Water Sales) = \$1.60624 per 1,000 Gallons.

Commission calculates an increase in purchased water expense of \$29,298.²⁵ Accordingly, the Commission denies Hardin District's proposed adjustment and finds that purchased water expense should be increased by \$29,298 to correspond with the adjustment to revenues from residential water sales.

Rate Case Amortization

Hardin District originally proposed to increase test period rate case amortization expense of \$1,958 by \$7,485 to reflect amortizing the cost of the current rate case proceeding over a 5-year amortization period. According to Hardin District, the \$1,958 test-period amortization expense represents the amortization of an earlier rate case that was fully amortized in 2006.²⁶ Hardin District proposes to reduce the pro forma rate case amortization expense by \$1,958 to eliminate the amortization of the prior rate case.²⁷

To prepare and process this current rate case application, Hardin District reports incurring legal and engineering fees of \$8,500 and \$28,925, respectively. Upon reviewing Hardin District's legal and engineering fees, the Commission concludes that they appear to be within a reasonable range and that the proposed 5-year amortization period is appropriate. Given that the amortization of the prior rate case cost will not be an on-going expense, it should not be included in Hardin District's pro forma operations.

²⁵ 18,240.000 Gallons x \$1.60624 per 1,000 Gallons = \$29,298.

²⁶ Hardin No. 1's Response to Commission Staff's Second Information Request, Item 23(a).

²⁷ Id.

For these reasons, the Commission accepts Hardin District's revised adjustment to increase rate case amortization expense by \$5,527 to a pro forma level of \$7,485.

Depreciation

Hardin District proposes to increase test-period depreciation expenses of \$584,313 by \$105,051 to a pro forma level of \$689,364.²⁸ According to Hardin District, there is only a partial year of depreciation included in the test-period depreciation expense for the assets placed into service during calendar year 2005.²⁹ Hardin District's proposed adjustment reflects the annual depreciation for those assets.³⁰ Upon review of Hardin District's proposed adjustment and the test-period depreciation schedules, the Commission finds that the proposed adjustment is reasonable and reflects the on-going level of depreciation expense. Accordingly, the Commission accepts Hardin District's adjustment to increase depreciation expense by \$105,051.

The Commission after considering the pro forma adjustments found reasonable herein, has determined that Hardin District's pro forma operations would be as shown in Table 2.

Table 2			
<u>Account Titles</u>	<u>Test-Period Operations</u>	<u>Pro Forma Adjustments</u>	<u>Pro Forma Operations</u>
Operating Revenues	\$ 3,644,599	\$ 88,282	\$ 3,732,881
Operating Expenses	2,664,268	343,252	3,007,520
Net Operating Income	\$ 980,331	\$ (254,970)	\$ 725,361
Interest Income	161,477	0	161,477
Inc. Available for Debt Service	\$ 1,141,808	\$ (254,970)	\$ 886,838

²⁸ Application, Exhibit 11, Revenue Requirement.

²⁹ Direct Testimony of Brent Tippey at 6.

³⁰ Id.

REVENUE REQUIREMENT DETERMINATION

Currently, Hardin District has three outstanding long-term debt issuances: two fixed interest-rate bonds and one variable interest-rate bond. The bond ordinances for the fixed-rate issuances require Hardin District to maintain a debt service coverage of 1.2x while the variable bond issuance does not have a coverage requirement. Using a 3-year average of its principal and interest payments for calendar years 2006 through 2008, Hardin District calculates a debt service for fixed-rate bonded debt of \$894,413 and a debt service for its variable-rate bonded debt of \$387,805.³¹ Using a 3-year average of its principal and interest payments for calendar years 2007 through 2009, the Commission calculates a debt service for fixed-rate bonded debt of \$894,412 and a debt service for the variable-rate bonded debt of \$390,409.

Table 3 is a comparison of the revenue requirement from water sales as requested by Hardin District of \$3,643,056 to the revenue requirement from water sales calculated by this Commission of \$3,731,877.

Table 3		
Description	Hardin District	Commission
Avg. Debt Service - Fixed Rate Debt	\$ 894,413	\$ 894,412
Multiplied by: Debt Service Coverage	x 0.2	x 0.2
Debt Service Coverage	\$ 178,883	\$ 178,882
Add: Avg. Debt Service - Fixed Rate Debt	894,413	894,412
Avg. Debt Service - Variable Rate Debt	387,805	390,049
Operating Expenses	2,197,027	2,318,156
Depreciation	+ 689,364	+ 689,364
Total Revenue Requirement	\$ 4,347,492	\$ 4,470,863
Less: Interest & Dividend Income	126,927	126,927
Nonutility Income	-	34,550
Revenue Requirement from Operations	\$ 4,220,565	\$ 4,309,386
Less: Other Operating Revenues	- 577,509	- 577,509
Revenue Requirement from Water Sales	\$ 3,643,056	\$ 3,731,877

³¹ Application, Exhibit 3, Schedule of Bond and Interest Requirements – 3 Year Average.

The requested revenue requirement is sufficient to pay the pro forma "cash" expenses and meet the debt service requirements of Hardin District's bond ordinances. Therefore, the Commission finds that Hardin District should be allowed to increase its rates to generate the requested revenue requirement from water sales of \$3,643,056.

RATE DESIGN

Hardin District included a cost-of-service study in its application. The study followed guidelines set out in the American Water Works Association Manual M-1 wherein costs were allocated among the various customer classes. The Commission accepts the cost-of-service study and again places Hardin District on notice that costs should be fully allocated in any future rate application and proposed rates should be fully justified with a cost-of-service study.

Hardin District's current rate design uses a customer charge and two declining block rate increments – the first step consists of the first 15,000 gallons of usage and the second step consists of usage over the 15,000-gallon level. Hardin District proposed no revisions to this rate design.

Hardin District sells water at a wholesale rate to Meade District, Hardin No. 2, and the cities of Hardinsburg and Vine Grove. Hardin District proposed to adjust its wholesale rate and retail rate by a weighted percentage and not in accordance with the results of its cost-of-service study. While acknowledging that the results of the cost-of-service study indicated its wholesale rate failed to recover the full cost of wholesale water service, Hardin District stated that it was not prepared to raise the wholesale rate to the levels necessary to obtain full cost recovery. Hardin District proposed the weighted percentage as a means of moving closer to rates that accurately reflect the actual cost of service. Hardin District proposes to adjust the wholesale rate by 38

percent and retail rates and public and private fire protection rates by 13.4 percent. The proposed method of increasing rates lessens the impact on certain classifications of customers, while moving toward cost-of-service rates. Hardin District indicated in the application that it intends to move to full cost-of-service study rates in future rate cases.

FOCUSED MANAGEMENT AUDIT

In Case No. 2001-00211, the Commission found that a focused management audit of Hardin District should be performed. We, however, took no action to implement this finding. While we still have concerns about Hardin District's management and operations, we are no longer of the opinion that a focused management audit is the appropriate or most cost effective means to address these concerns. We believe a financial examination or an accounting inspection can better address our concerns and will cause such examination to occur within 90 days of the date of a final Order.

CONCLUSION

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

1. Based upon adjusted test-period operations contained herein, Hardin District's total revenue requirement from water sales is \$3,731,877.

2. Hardin District's proposed rates will produce \$3,643,056 from water sales.

3. While the proposed rates will produce revenues less than Hardin District's total revenue requirement, the requested rate will not result in any degradation of service to the public.

4. "[I]n the absence of some showing that the service to the public will suffer by allowing...[a] utility to change 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.”³²

5. The proposed method of increasing rates is reasonable and should be approved.

6. Hardin District's proposed rates will produce revenues sufficient to meet adjusted test-period operating expenses, and the minimum debt service requirements of its long-term debt instruments.

IT IS THEREFORE ORDERED that:

1. Hardin District's proposed water rates, which are set forth in Appendix A, are approved for service rendered on and after the date of this Order.

2. Within 30 days of the date of this Order, Hardin District shall file with the Commission its revised tariff setting out the rates approved herein.

3. Three years from the date of this Order, Hardin District shall file an income statement, along with any pro forma adjustments, in sufficient detail to demonstrate that the rates approved herein are sufficient to meet its operating expenses and annual debt service requirements.

Done at Frankfort, Kentucky, this 2nd day of August, 2007.

By the Commission

ATTEST:



Executive Director

³² Utilities Operating Co. v. King, 143 So.2d 854, 858, 45 PUR3d 439, 443 (Fla. 1962).

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2006-00410 DATED August 2, 2007

The following rates and charges are prescribed for the customers in the area served by Hardin County Water District No. 1. 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.

Customer Charge

5/8	Inch Connection	\$	5.02
3/4	Inch Connection	\$	7.53
1	Inch Connection	\$	12.55
1 1/2	Inch Connection	\$	25.10
2	Inch Connection	\$	40.16
3	Inch Connection	\$	75.30
4	Inch Connection	\$	125.50
6	Inch Connection	\$	251.00

Water Rates

First 15,000 gallons	\$	4.42per 1,000 gallons
Over 15,000 gallons	\$	3.16per 1,000 gallons
Wholesale	\$	1.92per 1,000 gallons

Private Fire Protection Charges

Hydrant or Line Size

	Monthly Charge
1.5 Inch	\$ 0.64
2.0 Inch	\$ 1.37
3.0 Inch	\$ 4.00
4.0 Inch	\$ 8.51
6.0 Inch	\$ 24.70
8.0 Inch	\$ 52.67