

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE ADJUSTMENT OF JACKSON COUNTY)
WATER ASSOCIATION, INC. FOR APPROVAL) CASE NO. 2006-00467
OF A PROPOSED INCREASE IN RATES)

ORDER

On January 17, 2007, Jackson County Water Association, Inc. ("Jackson") filed an application for Commission approval of proposed water rates. Jackson's proposed rates would generate annual revenues of \$1,756,277, an increase of \$210,261, or 13.6 percent, over normalized test-year sales of \$1,546,016 and would increase the monthly bill of a residential customer using 4,000 gallons of water from \$26.80 to \$29.86, an increase of \$3.06 or 11.42 percent.

Upon request, intervention was granted to the Attorney General of the Commonwealth of Kentucky by Order dated February 19, 2007.

Commission Staff performed a limited financial review of Jackson's operations and prepared a report containing its findings and recommendations. In its report, Staff recommended that the Commission deny the rates proposed by Jackson and instead approve rates that would produce annual operating revenues from rates of \$1,680,569, a \$94,794, or 5.98 percent, increase over test-year normalized revenues from rates of \$1,585,775. Staff's recommended rates would increase the monthly bill of a residential customer using 4,000 gallons of water from \$26.80 to \$28.16, an increase of \$1.36 or 5.07 percent.

The Commission issued the Staff Report by Order dated April 13, 2007. That Order granted all parties 10 days to submit comments on the report and any request for an informal conference or hearing. No comments or requests were received from the Attorney General. The Commission received comments from Jackson on April 26, 2007, objecting to Staff's adjustments to Other Operating Revenue and Bad Debt Expense. Jackson did not request an informal conference or hearing in this matter.

In its application Jackson eliminated Other Operating Revenue of \$72,663 from test-year operations with no explanation. In its report Staff added the amount back stating this revenue was from late payment penalties and non-recurring charges and its inclusion is appropriate and necessary. In response to the Staff Report Jackson states that Staff is incorrect. Instead, Jackson argues, the Other Operating Revenue was from wholesale sales, bulk sales, and revenues from merchandising activities. In its response Jackson stated that the wholesale and bulk sales accounted for \$60,793 of the \$72,663 and since these wholesale and bulk sales were accounted for as water sales in its billing analysis, they must be removed from Other Operating Revenue as stated in the audit report or they would be included in total revenues twice. Jackson's response regarding merchandising activities is unclear other than to state they are not sure of the amount of this revenue due to limitations of their accounting system.

At issue is the amount of revenue generated from Jackson's present rates that should be applied against pro forma revenue requirements. As part of its application Jackson provided a billing analysis. A billing analysis is a summary of test-year water consumption and is used to test rate design. To test the accuracy of the water consumption reported in the billing analysis, rates in effect during the test year are

applied to the consumption. The results are then reconciled to revenues reported in the audited financial statements. In this case both Jackson and Staff have presented reconciliations for Commission review. Jackson's reconciliation is shown in its application at Exhibit 11. Staff's reconciliation was not explicitly stated in its report but its impact on the report was expressed through the increase to test-year water sales of \$16,455. A comparison of the reconciliations is presented in Table I with the differences shown in bold print.

Table I

	<u>Jackson</u>	<u>Staff</u>
Retail Sales by Meter Size		
5/8"	\$1,431,151	\$1,431,151
1"	5,783	5,783
1 1/2"	13,398	13,398
2"	37,129	37,129
3"	2,887	2,887
4"	<u>8,887</u>	<u>8,887</u>
Total Retail Sales Revenue	<u>1,499,235</u>	<u>1,499,235</u>
City of Beattyville	12,995	12,995
City of McKee	5,677	5,677
Rockcastle County Water	26,228	26,228
Bulk Sales	<u>1,880</u>	<u>1,880</u>
Total Wholesale Revenue	<u>46,780</u>	<u>46,780</u>
Other Operating Revenue	<u>0</u>	<u>72,663</u>
Total Operating Income	1,546,015	1,618,678
Interest Income	48,774	48,774
Miscellaneous Non-Operating Income	<u>528</u>	<u>528</u>
Total Revenue	<u>\$1,595,317</u>	<u>\$1,667,980</u>
Total Revenue Per Audit	<u>\$1,602,224</u>	<u>\$1,651,526</u>
Difference \$	<u>\$(6,907)</u>	<u>\$16,454</u>
Difference %	<u>(0.4330)%</u>	<u>0.9865%</u>

As shown in Table I Jackson's billing analysis results were within .433 percent of audited revenues as reconciled by Jackson and .9865 percent as reconciled by Staff, both of which are tolerable variances. However, in Jackson's reconciliation total audited revenue is stated in error at \$1,602,224. As shown in Table II the correct amount is \$1,651,526. The \$1,602,224 audited revenue used by Jackson includes operating revenue only and does not include non-operating revenue. Non-operating revenue must be included here to make a proper comparison since Jackson includes non-operating revenue in the total revenue of the billing analysis. Correcting this error restates Jackson's billing analysis variance to a negative \$56,209, or 3.52 percent ($\$56,209 / \$1,595,317$), of the billing analysis results.

Table II
Audited Revenue, Application, Exhibit 9

Water Sales	\$1,529,561
Other Operating Revenue	<u>72,663</u>
 Total Operating Revenue	 <u>1,602,224</u>
 Interest Income	 48,774
Miscellaneous Non-Operating Income	<u>528</u>
 Total Non-Operating Income	 <u>49,302</u>
 Total	 <u>\$1,651,526</u>

Jackson's reconciliation does not include an amount for Other Operating Revenue generated from non-recurring charges. This amount was stated in the audit report as \$72,663. Table III lists the non-recurring charges included in Jackson's tariff on file with the Commission. From these charges there was undoubtedly revenue collected during the test year that would be properly classified as Other Operating Revenue and factored into the determination of rates.

Table III

Connection/Turn-On Charge	\$36
Delinquent Account Disconnect	36
Field Collection Charge	36
Late Payment Penalty	10%
Meter Relocation Charge	Actual Cost
Meter Re-Read Charge	36
Meter Test Charge	50
Re-Connection Charge	36
Re-Connection Charge (After Hours)	50
Returned Check Charge	11
Service Call Investigation	36
Service Call Investigation (After Hours)	50

By adding Other Operating Revenue of \$72,663 to Jackson's billing analysis and reconciling the result to the proper total revenue reported in the audit, as done by Staff, the billing analysis variance is a positive \$16,454, or .99 percent.

In response to the Staff Report Jackson states that wholesale and bulk sales revenue total \$60,793 and not the \$46,780 as reported by Jackson in its billing analysis. Jackson did not provide billing information supporting the \$60,793 in wholesale and bulk sales revenue. The test-year gallons sold to wholesale and bulk customers are reported in Jackson's application and support the revenue stated in Jackson's billing analysis of \$46,780.

The Commission finds that the billing analysis reconciliation presented by Jackson does not support audited revenues and must be adjusted to include Other Operating Revenues. Without this adjustment Jackson's billing analysis variance is significantly greater than the variance of Staff's reconciliation. If wholesale and bulk sales were reported as Other Operating Revenue in the audit, as claimed by Jackson, then audited Water Sales must include at least a portion of Other Operating Revenues derived from Jackson's tariffed non-recurring charges, otherwise, the information

supplied in Jackson's application is not supported by its audited financial statements. Staff's inclusion of Other Water Sales of \$72,663 is appropriate.

Jackson reported test-year Bad Debt Expense of \$35,352, which represents 2.31 percent of test-year revenue from water sales of \$1,529,561. In its report, Staff stated that in its judgment this amount was excessive and the test-year amount should be decreased. Staff decreased the test-year amount by \$27,704 to restate Bad Debt Expense at .5 percent of test-year revenue from water sales. In support of its adjustment Staff referenced recently processed rate applications of three water entities of similar size to Jackson.

In response to Staff's report, Jackson argues that the customers of its territory do not have the same ability to pay water bills as those living in the areas served by the utilities referenced by Staff making Staff's adjustment unreasonable. To validate its position, Jackson offered the information presented in Table IV which represents statistics taken from the 2000 Census as presented at www.factfinder.census.gov.

Table IV

	Median Family <u>Income</u>	Unemployment <u>Rate</u>
East and West Laurel – London	\$34,340	3.40%
Harrison – Cynthiana	34,691	2.50
Booneville, Owsley County	17,500	3.30
Jackson County	23,638	4.30

When considering this issue the Commission compiled the information presented in Table V to compare Jackson's historic Bad Debt Expense stated as a percentage of water sales to Jackson County's unemployment rates. The water sales stated in Table V were taken from Jackson's audit reports on file with the Commission while the Bad

Debt Expenses were taken from Jackson's annual reports filed with the Commission. The unemployment rates were obtained at www.workforcekentucky.ky.gov.

Table V

Year	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Water Sales	\$1,309,390	\$1,413,366	\$1,513,781	\$1,529,561	\$1,502,127
Bad Debt Expense	18,645	16,354	20,589	35,352	14,751
Percent of Expense to Sales	1.42%	1.16%	1.36%	2.31%	0.98%
Unemployment Rate	7.80%	7.90%	6.60%	7.60%	9.70%

The information presented in Table V indicates that there is no direct correlation between the amounts reported by Jackson for Bad Debt Expense and Jackson County's unemployment rate. In fact, in 2006, when Jackson's reported Bad Debt Expense was the lowest for the years compared, Jackson County's unemployment rate was the highest.

Based on the historic information presented in Table V, the Commission finds that Jackson's test-year Bad Debt Expense is excessive. Of the five years compared the Bad Debt Expense stated as a percentage of water sales was the highest during the test year. All other years were significantly lower. However, the Commission is not compelled to order that the expense be decreased to the extent recommended by Staff since Staff offered only three utilities as a basis for its adjustment. The three utilities referenced by Staff may or may not represent the appropriate expectations of Jackson's ability to collect revenues.

The Commission finds that the appropriate level of bad debt in this case shall be .98 percent of pro forma present rate sales. This is the actual percentage reported by Jackson for 2006. This percentage was attained by Jackson during the 12-month

period immediately following the test year and reflects Jackson's current operations. The Commission's adjustment appears in Table VI and results in an increase in expenses of \$7,924 over the amount recommended by Staff.

Table VI

Pro Forma Present Rate Sales	\$1,585,775
Times: 2006 Bad Debt Expense Percent	<u>.98%</u>
Annual Recovery	15,572
Less: Test Year	<u>(35,352)</u>
Decrease by Commission	(19,780)
Plus: Staff Adjustment	<u>27,704</u>
Additional Allowed by Commission	<u>\$7,924</u>

The Commission's adjustment to Bad Debt Expense has no impact on the rates recommended in the Staff Report. The revenue requirement from rates recommended by Staff was \$1,680,569. The Commission's adjustment to Bad Debt Expense increases this amount to \$1,688,493 which is less than the revenues produced by the rates recommended in the Staff Report of \$1,695,296.¹

Also, in its report Staff noted that Jackson had all the normal policies and procedures in place to control bad debts. Jackson should exercise diligent application of its tariff to ensure that Bad Debt Expense is adequately controlled and maintained at a reasonable level in the future.

Except as found otherwise herein, the Commission finds that the recommendations and findings contained in the Staff Report are supported by the

¹ Staff Report, Attachment E, Page 9.

evidence of record, are reasonable, and should be adopted as the findings of the Commission.

IT IS THEREFORE ORDERED that:

1. Jackson's proposed rates are denied.
2. The recommendations and findings contained in the Staff Report, except as otherwise found in this Order, are supported by the evidence of record, are reasonable, and are adopted as the findings of the Commission.
3. The rates for water service as set out in Appendix A of this Order are approved for service rendered by Jackson on and after the date of this Order.
4. Within 30 days of the date of this Order, Jackson shall file with the Commission its revised tariff setting out the rates approved herein.

Done at Frankfort, Kentucky, this 19th day of June, 2007.

By Commission

ATTEST



Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2006-00467 DATED JUNE 19, 2007

The following rates and charges are prescribed for customers in the area serviced by Jackson County Water Association, Inc. 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 Rate:

5/8 Inch x 3/4 Inch Meter

First	2,000 gallons	\$15.00 Minimum Bill
Next	18,000 gallons	6.58 per 1,000 gallons
Next	30,000 gallons	5.45 per 1,000 gallons
Over	50,000 gallons	4.26 per 1,000 gallons

1 Inch Meter

First	5,000 gallons	\$34.85 Minimum Bill
Next	15,000 gallons	6.58 per 1,000 gallons
Next	30,000 gallons	5.45 per 1,000 gallons
Over	50,000 gallons	4.26 per 1,000 gallons

1 1/2 Inch Meter

First	10,000 gallons	\$67.75 Minimum Bill
Next	10,000 gallons	6.58 per 1,000 gallons
Next	30,000 gallons	5.45 per 1,000 gallons
Over	50,000 gallons	4.26 per 1,000 gallons

2 Inch Meter

First	20,000 gallons	\$133.55 Minimum Bill
Next	30,000 gallons	5.45 per 1,000 gallons
Over	50,000 gallons	4.26 per 1,000 gallons

3 Inch Meter

First	30,000 gallons	\$188.05 Minimum Bill
Next	20,000 gallons	5.45 per 1,000 gallons
Over	50,000 gallons	4.26 per 1,000 gallons

4 Inch Meter

First	40,000 gallons	\$242.55 Minimum Bill
Next	10,000 gallons	5.45 per 1,000 gallons
Over	50,000 gallons	4.26 per 1,000 gallons

Whole Sale Rates

Rockcastle County Water Association	\$2.66 per 1,000 gallons
City of Beattyville	\$2.55 per 1,000 gallons
City of McKee	\$2.39 per 1,000 gallons
<u>Bulk Loading Station</u>	\$2.25 per 1,000 gallons