

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF KENTUCKY-AMERICAN)	
WATER COMPANY FOR AN ADJUSTMENT OF)	CASE NO.
ITS WASTEWATER RATES PURSUANT TO 807)	2014-00390
KAR 5:076)	

ORDER

On November 14, 2014, Kentucky-American Water Company (“Kentucky-American”) applied to adjust its rates for sewer service pursuant to the alternative rate adjustment procedure for small utilities, 807 KAR 5:076. After Kentucky-American corrected filing deficiencies, its Application was accepted for filing on December 9, 2014. On December 23, 2014, the Commission issued an Order establishing a procedural schedule to ensure the orderly review of Kentucky-American’s Application.

By this Order, the Commission approves sewer rates that will generate \$185,648 in additional annual revenues, a 62 percent increase to pro forma present rate revenues of \$299,406. The increase in sewer rates will occur in four phases over 48 months and will ultimately increase the monthly sewer bill¹ of a residential customer who uses 5,000 gallons of water monthly as follows:

	Current	Phase IV Proposed Rates		
	Rates	Bill	\$ Increase	% Increase
Rockwell	\$ 20.75	\$ 34.00	\$ 13.25	63.9%
Owenton–Inside City	\$ 37.45	\$ 61.36	\$ 23.91	63.8%
Owenton–Outside City	\$ 52.46	\$ 61.36	\$ 8.90	17.0%

¹ There are only 19 Owenton outside-city customers. Kentucky American states that preparing a cost-of-service study for the Owenton system is not economically feasible. Therefore, it is proposing to freeze the Owenton outside rates until such time as all Owenton customers are paying the same rate.

Kentucky-American indicated in its application that it could justify a revenue increase of \$190,224, but proposed a rate increase phased in over two years that would limit the additional revenues to \$61,183 over pro forma test-year revenues.² Commission Staff applied methods and practices that are generally accepted by the Commission to review the reasonableness of Kentucky-American's pro forma financial statements, revenue requirement calculation, and requested sewer rates. On March 31, 2015, Commission Staff issued a report finding that Kentucky-American's adjusted test-year operations would support a revenue requirement from its sewer operations of \$489,559 and, therefore, a revenue increase of \$185,648.³

On April 14, 2015, Kentucky-American filed its response to Commission Staff's report and accepted Commission Staff's findings that Kentucky-American could justify a \$185,643 increase in revenue requirement for an overall revenue of \$489,559. The utility further accepted Commission Staff's findings that a rate increase of 62 percent would produce the revenue requirement of \$489,559. For the purposes of gradualism, Kentucky-American amended its Application to request that the rate increase be implemented with annual rate changes over a four-year period, instead of the two-year period initially requested. Kentucky-American requested that the Informal Conference scheduled for April 28, 2015, be cancelled, that a hearing not be held, and that the matter be submitted on the record. Kentucky-American further requested that it not be required to file a separate tariff for its sewer division at this time, because it is in the

² Staff Report at 1.

³ Staff Report at 19.

process of revising its tariff for the water division⁴ and intends to present the revised tariffs to the Commission prior to the end of 2015.

In its April 23, 2015 Order, the Commission cancelled the informal conference that was scheduled for April 28, 2015. Kentucky-American was ordered to publish a one-time notice following the requirements of 807 KAR 5:076, Section 5, of its Amended rates and to submit proof of publication of the notice with the Commission no later than May 25, 2015. On May 11, 2015, Kentucky-American submitted the requested proof that notification had been mailed to each customer.

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

1. Kentucky-American, a Kentucky corporation, owns and operates sewage collection and treatment facilities in Owen and Clark counties, Kentucky, that provide service to 718 customers.⁵

2. Kentucky-American should be relieved of the obligation set forth in the December 23, 2014 Order to file a witness list.

3. The calendar year ending December 31, 2013, should be used as the test period to determine the reasonableness of Kentucky-American's existing and proposed wastewater rates.⁶

⁴ Kentucky-American's water tariff currently on file contains rates and regulations for its sewer service.

⁵ *Annual Report of Kentucky-American Water Company aka Ky. Water, Sewer Div. to the Public Service Commission for the Calendar Year Ended December 31, 2013* at 25.

⁶ 807 KAR 5:076, Section 9.

4. Based upon pro forma test-year operations, after adjusting for known and measurable changes, Kentucky-American's total pro forma revenues and total operating expenses are \$303,911 and \$373,510, respectively.⁷

5. The Commission has historically used the operating-ratio method to calculate the revenue requirement for small privately owned sewer utilities.⁸

6. Using the operating-ratio method, Commission Staff determined that Kentucky-American's pro forma operations support an overall revenue requirement of \$485,559, and an increase to sewer service revenue of \$185,648, or 62 percent.⁹

⁷ Staff Report at 7.

⁸ An operating ratio measures the difference between operating revenues and operating expenses. It is defined by the following equation:

$$\text{Operating Ratio} = \frac{\text{Operation \& Maintenance Exp. + Depreciation + Taxes}}{\text{Gross Revenues}}$$

The Commission has found that the operating ratio is a reasonable and necessary alternative to the rate-of-return method for calculating the allowable Net Operating Income for small-sewer investor-owned utilities. Specifically, it has found that the rate-of-return method cannot be used because there is "no basis" upon which to determine a rate of return for these utilities, Administrative Case No. 95-236, *Application of Thelma Waste Control, Inc. for a Rate Adjustment Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC. Apr. 15, 1996) at 6. Further, it has found that the operating-ratio method is appropriate when plant investment is low and operating expenses are high, Case No. 7982, *Notice of Application of Fern Lake Company* (Ky. PSC. Aug. 27, 1981) at 3.

⁹ \$373,510 (Pro Forma Operating Expenses) ÷ 88% (Operating Ratio) = \$424,443 + \$32,427 (Provision for Federal and State Income Taxes) + \$32,689 (Interest Expense) = \$489,559 (Overall Revenue Requirement) - \$4,505 (Other Operating Revenue) - \$299,406 (Normalized Revenue from Sewer Service) = \$185,648.

7. Throughout all phases of the implementation of the proposed rate adjustment, Kentucky-American's proposed rates will produce sufficient revenues to produce an annual cash working capital allowance.¹⁰

8. The record contains no evidence that permitting Kentucky-American to assess its proposed rates will result in any degradation of reduction in the quality of service that Kentucky-American currently provides.

9. A utility may propose rates that produce a level of revenues that accepted ratemaking methodologies would regard as insufficient or inadequate. Absent evidence that the quality of the utility's service will decline or be degraded as a result of the level of revenue, the proposed rates should be accepted.¹¹

10. Kentucky-American proposes to increase its sewer rates in four phases. Based upon normalized test-period water usage, the sewer rates proposed for the final phase would produce annual revenues of approximately \$486,812.

	Phase I	Phase II	Phase III	Phase IV
Revenues from Rates	\$ 337,697	\$ 381,008	\$ 430,366	\$ 486,812
Other Operating Revenues	4,505	4,505	4,505	4,505
Total Operating Revenues	342,202	385,513	434,871	491,317
Less: Pro forma Operating Expenses	(373,510)	(373,510)	(373,510)	(373,510)
	(32,689)	(32,689)	(32,689)	(32,689)
Subtotal	(63,997)	(20,686)	28,672	85,118
Add Depreciation Net Amortization	76,509	76,509	76,509	76,509
Cash Working Capital	\$ 12,512	\$ 55,823	\$ 105,181	\$ 161,627

¹¹ *Utilities Operating Co. v King*, 143 So2d 854, 45 PUR.3d 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. 7 for a General Rate Adjustment Effective on and after December 2, 2006* (Ky. PSC Aug. 2, 2007); and 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).

11. Within 20 days of entry of the this Order, using the Commission's electronic Tariff Filing System, Kentucky-American should:

- a. File a separate and distinct tariff for its sewer service;
- b. Include the rates and effective dates for all four phases in the separate and distinct sewer service tariff; and
- c. Remove from its water tariff any pages referencing sewer services.

IT IS THEREFORE ORDERED that:

1. Kentucky-American is relieved of the obligation set forth in the December 23, 2014 Order to file a witness list.
2. The sewer service rates set forth in Kentucky-American's original application are denied.
3. Kentucky-American's request for four annual rate increases based on Commission Staff's findings that Kentucky-American could justify a \$185,643 increase in the revenue requirement for an overall revenue of \$489,559 is granted.
4. The Phase 1 rates set forth in Appendix A to this Order are approved for service rendered by Kentucky-American on and after the date of this Order.
5. The Phase 2 rates set forth in Appendix B to this Order are approved for service rendered by Kentucky-American effective the day after the first anniversary of the date of this Order.
6. The Phase 3 rates set forth in Appendix C to this Order are approved for service rendered by Kentucky-American effective the day after the second anniversary of the date of this Order.

7. The Phase 4 rates set forth in Appendix D to this Order are approved for service rendered by Kentucky-American effective the day after the third anniversary of the date of this Order.

8. One month prior to the effective date of the Phase 2, Phase 3, and Phase 4 rates, Kentucky-American shall publish a one-time notice following the requirements of 807 KAR 5:076, Section 5. The customer notice shall be in the format set forth in the Appendix to the April 23, 2015 Order in this case, and shall contain only the rate comparison being implemented for that rate phase.

9. Within 45 days of publishing the notice required in ordering paragraph number 8, Kentucky-American shall file proof of notice as required pursuant to 807 KAR 5:076, Section 5(3).

10. Within 20 days of entry of this Order, using the Commission's electronic Tariff Filing System, Kentucky-American shall:

- a. File a separate and distinct tariff for its sewer service;
- b. Include the rates and effective date for all four phases in the separate and distinct sewer service tariff; and
- c. Remove from its water tariff any pages referencing sewer services.

11. Any documents filed in the future pursuant to ordering paragraph 9 of this Order shall reference this case number and shall be retained in the utility's general correspondence file.

12. The Executive Director is delegated authority to grant reasonable extensions of time for the filing of any documents required by this Order upon Kentucky-American's showing of good cause for such extension.

By the Commission

ENTERED
JUL 02 2015
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

Aaron D. Brunwell for
Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2014-00390 DATED JUL 02 2015

The following rates and charges are prescribed for the customers in the area served by Kentucky-American Water Company for sewer service rendered on and after the date of this Order. 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 SEWAGE RATES

PHASE 1

Owenton-Inside City Rates

		<u>Per 1,000 gallons</u>	<u>Per 100 gallons</u>
First	2,000 gallons	\$19.54 Minimum bill	\$19.54 Minimum bill
Next	1,000 gallons	8.87 per 1,000 gallons	0.887 per 100 gallons
Next	2,000 gallons	6.98 per 1,000 gallons	0.698 per 100 gallons
Next	5,000 gallons	6.33 per 1,000 gallons	0.633 per 100 gallons
Next	10,000 gallons	5.66 per 1,000 gallons	0.566 per 100 gallons
Next	20,000 gallons	4.99 per 1,000 gallons	0.499 per 100 gallons
Over	40,000 gallons	4.75 per 1,000 gallons	0.475 per 100 gallons

Owenton-Outside City Rates

		<u>Per 1,000 gallons</u>	<u>Per 100 gallons</u>
First	2,000 gallons	\$24.18 Minimum bill	\$24.18 Minimum bill
Next	1,000 gallons	10.98 per 1,000 gallons	1.098 per 100 gallons
Next	2,000 gallons	8.65 per 1,000 gallons	0.865 per 100 gallons
Next	5,000 gallons	7.82 per 1,000 gallons	0.782 per 100 gallons
Next	10,000 gallons	6.99 per 1,000 gallons	0.699 per 100 gallons
Next	20,000 gallons	6.17 per 1,000 gallons	0.617 per 100 gallons
Over	40,000 gallons	5.88 per 1,000 gallons	0.588 per 100 gallons

Rockwell Village

First	12,000 gallons	\$23.48	Minimum bill
Over	12,000 gallons	0.1956	per 100 gallons

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2014-00390 DATED **JUL 02 2015**

The following rates and charges are prescribed for the customers in the area served by Kentucky-American Water Company for sewer service effective the day after the first anniversary of the date of this Order. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission as of the date of implementation of Phase 1 rates.

MONTHLY SEWAGE RATES

PHASE 2

Owenton—Inside City Rates

		<u>Per 1,000 gallons</u>	<u>Per 100 gallons</u>
First	2,000 gallons	\$22.11 Minimum bill	\$22.11 Minimum bill
Next	1,000 gallons	10.04 per 1,000 gallons	1.004 per 100 gallons
Next	2,000 gallons	7.90 per 1,000 gallons	0.790 per 100 gallons
Next	5,000 gallons	7.16 per 1,000 gallons	0.716 per 100 gallons
Next	10,000 gallons	6.40 per 1,000 gallons	0.640 per 100 gallons
Next	20,000 gallons	5.65 per 1,000 gallons	0.565 per 100 gallons
Over	40,000 gallons	5.37 per 1,000 gallons	0.537 per 100 gallons

Owenton—Outside City Rates

		<u>Per 1,000 gallons</u>	<u>Per 100 gallons</u>
First	2,000 gallons	\$24.18 Minimum bill	\$24.18 Minimum bill
Next	1,000 gallons	10.98 per 1,000 gallons	1.098 per 100 gallons
Next	2,000 gallons	8.65 per 1,000 gallons	0.865 per 100 gallons
Next	5,000 gallons	7.82 per 1,000 gallons	0.782 per 100 gallons
Next	10,000 gallons	6.99 per 1,000 gallons	0.699 per 100 gallons
Next	20,000 gallons	6.17 per 1,000 gallons	0.617 per 100 gallons
Over	40,000 gallons	5.88 per 1,000 gallons	0.588 per 100 gallons

Rockwell Village

First	12,000 gallons	\$26.57	Minimum bill
Over	12,000 gallons	0.2504	per 100 gallons

APPENDIX C

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2014-00390 DATED **JUL 02 2015**

The following rates and charges are prescribed for the customers in the area served by Kentucky-American Water Company for sewer service effective the day after the second anniversary of the date of this Order. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission as of the date of implementation of Phase 2 rates.

Monthly Sewage Rates

PHASE 3

Owenton—Inside and Outside City Rates

	<u>Per 1,000 gallons</u>	<u>Per 100 gallons</u>
First 2,000 gallons	\$25.02 Minimum bill	\$25.02 Minimum bill
Next 1,000 gallons	11.36 per 1,000 gallons	1.136 per 100 gallons
Next 2,000 gallons	8.94 per 1,000 gallons	0.894 per 100 gallons
Next 5,000 gallons	8.10 per 1,000 gallons	0.810 per 100 gallons
Next 10,000 gallons	7.24 per 1,000 gallons	0.724 per 100 gallons
Next 20,000 gallons	6.39 per 1,000 gallons	0.639 per 100 gallons
Over 40,000 gallons	6.08 per 1,000 gallons	0.608 per 100 gallons

Rockwell Village

First 12,000 gallons	\$30.06 Minimum bill
Over 12,000 gallons	0.2504 per 100 gallons

APPENDIX D

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2014-00390 DATED **JUL 02 2015**

The following rates and charges are prescribed for the customers in the area served by Kentucky-American Water Company for sewer service effective the day after the third anniversary of the date of this Order. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission as of the date of implementation of Phase 3 rates.

Monthly Sewage Rates

PHASE 4

Owenton—Inside and Outside City Rates

		<u>Per 1,000 gallons</u>	<u>Per 100 gallons</u>
First	2,000 gallons	\$28.29 Minimum bill	\$28.29 Minimum bill
Next	1,000 gallons	12.85 per 1,000 gallons	1.285 per 100 gallons
Next	2,000 gallons	10.11 per 1,000 gallons	1.011 per 100 gallons
Next	5,000 gallons	9.16 per 1,000 gallons	0.916 per 100 gallons
Next	10,000 gallons	8.19 per 1,000 gallons	0.819 per 100 gallons
Next	20,000 gallons	7.22 per 1,000 gallons	0.722 per 100 gallons
Over	40,000 gallons	6.89 per 1,000 gallons	0.689 per 100 gallons

Rockwell Village

First	12,000 gallons	\$34.00 Minimum bill
Over	12,000 gallons	0.283 per 100 gallons

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