

Case No.: 2005-00174
Questions From: Christian County Water District – September 9, 2005
Response from: Hopkinsville Water Environment Authority
Sponsoring Witness: Jennings Rowe McKinley II

DATA REQUEST NO. 22.

Refer to the Black & Veatch study, page 18. What is a reasonable margin of coverage in excess of anticipated minimum bond coverage requirements?

- b. Is a municipality allowed to accumulate such a surplus of revenue?

RESPONSE:

Setting a debt service coverage target at a level above the minimum required level does not necessarily generate “a surplus of revenue.” There are numerous valid and legal uses of revenues which are generated in excess of operation and maintenance expenses and parity bond debt service payments. Parity bond debt service coverage is generally computed by dividing net operating income [generally equal to total system revenues less operation and maintenance expense (excluding annual depreciation expense)] by parity (senior) bond debt service payments. If the annual debt service coverage is established at 115%, such as it is for HWEA, this means that after payment of operation and maintenance expenses and parity bond debt service, HWEA must annually have additional revenue from annual rate revenues equal to at least 15% of the annual debt service on parity bonds. This additional revenue generated from debt service coverage requirements can be used to pay debt service on junior lien bonds, finance normal annual capital renewals and replacements, cash finance a portion of major capital improvements, make payments into required reserve funds, and many other valid uses.

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c. On page 20 of the study it is stated that such margin is needed to allow for fluctuations in climate or system operations. Rather than including this margin, is it not better ratemaking to adjust rates in the future if those fluctuations occur, rather than over-billing customers now for expenses that may never materialize?

RESPONSE:

In order to comply with the annual debt service coverage requirements set forth in the revenue bond indentures for most municipal utilities, the annual debt service coverage covenant must be met from annual system revenues. Having an unexpected shortfall in revenues (due to a large customer leaving the system, having abnormally rainy weather which generally reduces water sales and associated revenues, a downturn in the local economy, or other reasons) or an unexpected increase in expenses (due to a jump in gasoline prices, electric energy costs, chemical costs, or other factors) may reduce the utility's annual debt service coverage ratio to below the required debt service coverage levels. If this happens, the utility cannot go back and "correct" or "fix" history – it has missed its debt service coverage covenant for that year. The financial markets are not sympathetic to utilities that do not provide and plan for events such as mentioned above. Hence the necessity for having targeted debt service coverage levels in excess of the minimum required levels set forth in the bond covenants.

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d. How are the fluctuations consistent with the ratemaking principle of known and measurable?

RESPONSE:

Historical experience for most utilities would indicate that these types of variations have occurred and can reasonably be expected to continue to occur. It is therefore appropriate to consider this precedent by practicing prudent financial planning and providing for such variances by maintaining adequate debt service coverage margins above the minimum levels required.

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DATA REQUEST NO. 23.

Refer to the Black & Veatch study, page 19. Line 17 lists payments to CCWD. These payments end in 2006. Given that the study seems to cover a period through 2009, why should this expense be included, when it will not be incurred after 2006?

RESPONSE:

The study period considered in the B&V Report is FYs 2005 through 2009. Since the payment to the CCWD occurs in FYs 2005 and 2006 they are within the stated study period and within the test year, FY 2006, used in the B&V Report.

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DATA REQUEST NO. 24.

Refer to the Black & Veatch study page 23. How were function costs allocated to CCWD.

a. Were these costs allocated to CCWD in the same manner as to the retail customers? If not, explain why not.

RESPONSE:

Plant investment and associated test year capital related revenue requirements were allocated to CCWD on the basis of their contract capacity of 2 million gallons per day (mgd) versus the total HWEA water treatment plant capacity of 10 mgd. The CCWD was allocated 20% of investment associated with source of supply, large distribution mains, pumping, storage, and treatment plant. The operating expenses associated with source of supply, purification, and large mains were allocated to the CCWD on the basis of test year water usage and demands for the test year.

As discussed above, the capital related revenue requirements for the test year were allocated to CCWD on a contract demand basis. The balance of capital costs were allocated among the retail customers based on their test year water usage and demands. Operation and maintenance expenses were allocated among all customers based on test year water usage and demands.

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DATA REQUEST NO. 25.

How were the maximum day and maximum hour demand factors determined for the retail and wholesale customers?

- a. If estimated, explain the method and assumptions used..

RESPONSE:

Please see HWEA's Responses to Commission Information Request Nos. 13a and 13b.

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DATA REQUEST NO. 26.

Refer to the Black & Veatch study page 25. What size mains were allocated to CCWD?

- a. Explain why those mains were used.

RESPONSE:

Costs and investment associated with mains 6 inches in diameter and larger are allocated to the CCWD because the CCWD has connections to the HWEA system to mains which are 6 inches in diameter and larger.

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DATA REQUEST NO. 26.

Refer to the Black & Veatch study page 25. What size mains were allocated to CCWD?

b. If the rate for CCWD is based on the retail rate times 1.3, are not all distribution mains allocated to the District to the extent they are included in the retail rate?

RESPONSE:

The cost of service developed for the CCWD does not include Small Distribution Mains. Please see HWEA's Response to CCWD Data Request No. 17 for an explanation of the development of the proposed rates for the CCWD. The proposed schedule of rates for the CCWD recovers the allocated cost of service.

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DATA REQUEST NO. 26.

Refer to the Black & Veatch study page 25. What size mains were allocated to CCWD?

c. If yes, is not the proposed rate for CCWD inconsistent with the cost of service principles discussed on page 23 – 25?

RESPONSE:

Please see HWEA's Responses to CCWD Data Request Nos. 26a. and 26b.

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DATA REQUEST NO. 27.

Refer to Black & Veatch study page 26. The study says that CCWD is allocated 20 percent of investment related to supply, large distribution mains, pumping, storage, and treatment plan. If the rate for CCWD is based on a retail rate times 1.3, is not the allocation of these investments greater than 20 percent? Explain.

a. Are operating expenses allocated at 20 percent? If not, what is the percentage allocation?

RESPONSE:

The cost of service developed for the CCWD includes 20% of investment related to supply, large distribution mains, pumping, storage, and treatment. Please see HWEA's Response to CCWD Data Request No. 17 for an explanation of the development of the proposed rates for the CCWD. The proposed schedule of rates for the CCWD recovers the allocated cost of service.

