

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF WATER SERVICE )  
CORPORATION OF KENTUCKY FOR AN ) CASE NO. 2005-00325  
ADJUSTMENT OF RATES )

O R D E R

Water Service Corporation of Kentucky ("Water Service") has applied for an adjustment in its base water, fire hydrant, and sprinkler rates that will generate annual revenues of \$2,197,092, which is an approximate 60.18 percent increase or \$825,423 above its pro forma operating revenues from water rates of \$1,371,669. In its December 12, 2006 responses to a Commission Staff request,<sup>1</sup> Water Service proposes to modify the fire hydrant and sprinkler charges by consolidating the 16 separate classifications into 3 and by not increasing the rates that were being charged for these services during the test period. By this Order, the Commission establishes base water rates for Water Service that will produce an annual increase in revenues of \$453,982 and approves Water Service's modified fire hydrant and sprinkler rates.

BACKGROUND

Water Service, a Kentucky corporation, is a utility subject to Commission jurisdiction. KRS 278.010(3)(d). It owns and operates facilities that treat and distribute water to the public for compensation in the cities of Middlesboro and Clinton, Kentucky.

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<sup>1</sup> Water Service's Response to Item 3 of Commission Staff's Fourth Information Request.

During the calendar year 2005, Water Service reports providing retail water service to 8,455 customers. It last applied for a rate adjustment in 1989.<sup>2</sup>

#### PROCEDURE

Water Service submitted written notice of its intent to file an application for an adjustment of rates on August 4, 2005. It subsequently tendered its application on September 30, 2005. The application did not meet the minimum filing requirements, but all deficiencies were cured and the application was deemed filed as of December 1, 2005. On December 19, 2005, the Commission suspended the rates for 5 months from January 1, 2006 up to and including May 31, 2006 and established this proceeding to investigate the reasonableness of Water Service's proposed rates. The Attorney General of the Commonwealth of Kentucky ("AG") is the only Intervenor in this proceeding.

In the May 2, 2006 telephone conference, Water Service explained that it had discovered an error in its calculation of the proposed rates. Water Service erroneously used water purchases for Customer No. 16079 of 313,312,200 gallons, an overstatement of 284,866,000 gallons above the actual test-period purchases of 28,446,200 gallons.<sup>3</sup> The error did not impact the requested revenue increase of \$825,423, but did result in a significant revision to the proposed rates. On May 5, 2006, Water Service filed a revised schedule of rates and notified the Commission that those rates would become effective on June 9, 2006. Finding that Water Service's

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<sup>2</sup> Case No. 1989-00340, The Application and Notice of the Aqua Corporation (Kentucky Water Service Co., Inc.) for an Adjustment of Rates in Middlesboro and Clinton, Kentucky (Ky. PSC October 10, 1990).

<sup>3</sup> Exhibit 9 of the Application, Summary of the Calculation of the Revenue Requirement.

submission of the latter schedule of rates constitutes withdrawal of the original schedule of rates, the Commission suspended the latter schedule of rates up to and including November 9, 2006, or until the Commission completes its review of Water Service's application, whichever occurs first. The 10-month statutory deadline is March 2, 2007.

#### JOINT STIPULATION AND RECOMMENDATION

Pursuant to a request by Water Service, an informal conference was scheduled and held on August 22, 2006, for the purpose of settlement discussions. All parties, including Staff, were in attendance at the settlement conference. During the settlement negotiations the AG and Water Service reached an agreement on the level of the revenue requirement. At the August 24, 2006 hearing, Water Service and the AG filed their Joint Stipulation and Recommendation ("Joint Stipulation") which is attached hereto as Appendix A. The following is a brief synopsis of the Joint Stipulation:

1. The parties agreed to a reduction of \$371,441 from the originally requested revenue increase of \$825,423, for an amended annual increase of \$453,982, which is an increase of 33.1 percent above reported operating revenues.
2. The \$453,982 increase will be recovered by an equal adjustment to each of the current rate blocks for Clinton and Middlesboro.

Water Service and the AG agree that the Joint Stipulation is a mutually satisfactory resolution of all of the issues in the instant proceeding. Therefore, they urge the Commission to accept this Joint Stipulation in its entirety. While the overall reasonableness of the Joint Stipulation is an important factor, the Commission is bound by law to act in the public interest and review all elements of the Joint Stipulation. In determining whether the results of the proposed settlement are in the public interest and

beneficial to the ratepayers, the Commission considered the fact that the Joint Stipulation is unanimous and that the participation of the Intervenor ensures that a wide range of interests are represented.

The Joint Stipulation sets forth only the amount of revenue increase agreed to and not the underlying calculations and adjustments. In determining the overall reasonableness of the proposed \$453,982 increase in Water Service's annual operating revenues, the Commission has evaluated Water Service's proposed adjustments to capital, rate base, operating revenues, and operating expenses in light of our normal rate-making treatment. In addition, consideration has been given to the rates of return on common equity authorized by the Commission in recent rate cases. Based on a review of all these factors and the evidence of record, the Commission finds that the earnings resulting from the Joint Stipulation fall within a range reasonable for both Water Service and its ratepayers. The \$453,982 revenue increase provided for in the Joint Stipulation will result in fair, just, and reasonable rates for Water Service.

Based upon a review of all aspects of the Joint Stipulation, an examination of the record, and being otherwise sufficiently advised, the Commission finds that the Joint Stipulation is in the public interest and should be approved. The Commission's approval of this settlement is based solely on its reasonableness in toto and does not constitute the approval of any rate-making adjustment or revenue allocation.

#### RATE DESIGN

The rates were not calculated at the time of the settlement conference, nor were they attached to the Joint Stipulation. On September 22, 2006, Water Service submitted its stipulated base water rates along with the calculation of the revenue

requirement proving that the stipulated rates produce the agreed to revenue requirement. Upon review of the stipulated base water rates and the information submitted September 22, 2006, the Commission finds that they produce the revenue requirement determined reasonable herein and, therefore, should be approved.

FIRE HYDRANT AND SPRINKLER CHARGES

At the August 22, 2006 settlement conference, Water Service admitted that it is proposing several charges, attached hereto as Appendix B, that are neither listed in the current tariff nor were described in the application. In its letter dated October 5, 2006, Water Service states that the flat rates it is proposing to include in its tariff are for "fire protection and sprinkler systems." As previously mentioned, Water Service is proposing to consolidate the 16 proposed fire hydrant and sprinkler classifications into 3 classifications. The consolidated fire hydrant and sprinkler charges are shown in Table 1 below.

Table 1	
<u>Descriptions</u>	<u>Monthly Charges</u>
Private Hydrants or Sprinkler Systems	\$15.00 per hydrant or sprinkler
Clinton Municipally Owned Hydrants	\$3.33 per hydrant
Middlesboro Municipally Owned Hydrants	\$3.33 per hydrant

Water Service claims that it only became aware that the fire hydrant and sprinkler charges were not listed in its tariff during the preparation of its rate application.<sup>4</sup> If the Commission requires a refund or assesses a penalty for the non-tariffed charges, Water Service states that the Commission will be holding it responsible for an alleged violation of the statutes and regulations committed by a predecessor owner.<sup>5</sup> By including the

<sup>4</sup> Letter from Water Service dated October 5, 2006 at 2.

<sup>5</sup> Id. at 4.

fees in the tariffs proposed in the application, Water Service argues that the Commission and customers were given proper notice of the rates and that this notice adequately corrected a prior error.<sup>6</sup> Water Service further argues that it neither willfully nor knowingly collected an untariffed fee nor did it have control over the actions of a prior owner.<sup>7</sup>

Water Service proposes to recognize the flat rates listed above as current, but without any increase as part of this rate proceeding. Water Service states that it “believes that there is no basis to reject the proposed tariffs simply because of some lack of regulatory compliance on the part of the prior owners of the company.”<sup>8</sup>

In investigating Water Service’s prior tariffs, the Commission discovered that the fire hydrant and sprinkler charges were listed on a tariff that was canceled in August 1992. The tariff workpapers show that there was a concern that the language on the tariff pages dealing with the hydrant and sprinkler charges did not comply with 807 KAR 5:066, Section 10(2)(b). A letter was issued requesting Aqua/KWS, Inc.<sup>9</sup> to modify the language on those pages to comply with that regulation. However, the records do not indicate that the tariff pages were ever filed.

The Commission is concerned that Water Service apparently only became aware that its fire hydrant and sprinkler charges were not listed in its tariff when it began the process of preparing the rate application. Since August 1992, the date the tariff pages

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<sup>6</sup> Id.

<sup>7</sup> Id.

<sup>8</sup> Id.

<sup>9</sup> This was the name of the utility that owned the assets supplying water to Middlesboro and Clinton when the fire hydrant and sprinkler tariffs were canceled.

were cancelled, Aqua/KWS has been transferred 3 separate times.<sup>10</sup> During these transfers the acquiring parties should have noticed the discrepancy between the rates being charged and the rates contained in the tariff when they conducted their due diligence discovery. Furthermore, Water Service was aware that the fees were not included in their tariff at the time the application was filed, but did not admit this until requested by Staff at the August 22, 2006 settlement conference. Arguably, based on the apparent facts, the "filed rate doctrine" could require that Water Service refund the amounts collected for the hydrant and sprinkler charges during parts or all of the period they were not included on their tariff. Therefore, the Commission will hereafter issue a show cause order to review this matter.

If the fire hydrant and sprinkler charges are denied, then Water Service would be providing these services to its customers without compensation. Also, Water Service is proposing to implement the rates that the Commission had deemed reasonable prior to 1992. For these reasons the Commission finds that the fire hydrant and sprinkler charges should be approved on a prospective basis.

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<sup>10</sup> Case No. 2002-00142, Joint Application of Aqua/KWS, Inc., Utilities of Kentucky, Inc., and Water Service Corporation of Kentucky for Approval of the Transfer of the Ownership of the Assets Of Aqua/KWS, Inc. and Utilities of Kentucky, Inc. to Water Service Corporation of Kentucky Pursuant to the Provisions of KRS 278.020(4) and (5) and 807 KAR 5:001, Section 8 (Ky. PSC June 14, 2002).

Case No. 1998-00291, The Application of Aqua/KWS, Inc. for Approval of Transfer of Stock to Utilities of Kentucky, Inc. (Ky. PSC July 27, 1998).

Case No. 2005-00433, The Joint Application of Nuon Global Solutions USA, BV, Nuon Global Solutions USA, Inc., AIG Highstar Capital II, LP, Hydro Star, LLC, Utilities, Inc. and Water Service Corporation of Kentucky for Approval of an Indirect Change in Control of a Certain Kentucky Utility Pursuant to the Provisions of KRS 278.020(5) And (6) and 807 KAR 5:001, Section 8 (Ky. PSC March 8, 2006).

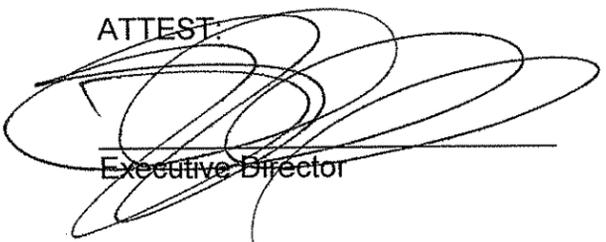
IT IS THEREFORE ORDERED that:

1. The rates and charges proposed by Water Service in its application are denied.
2. The Settlement Agreement, attached hereto as Appendix B, is approved in its entirety.
3. The rates set forth in Appendix C are approved for service rendered by Water Service on and after the date of this Order and will produce gross annual revenues as found reasonable herein.
4. Within 30 days from the date of this Order, Water Service shall file with this Commission revised tariff sheets setting out the rates and charges approved herein.

Done at Frankfort, Kentucky, this 28th day of February, 2007.

By the Commission

ATTEST:



Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 2005-00325 February 28, 2007.

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ADJUSTMENT OF RATES OF WATER )  
SERVICE CORPORATION OF KENTUCKY ) CASE NO. 2005-00325  
)

JOINT SETTLEMENT STIPULATION AND RECOMMENDATION

It is the intent and purpose of the parties to this proceeding, namely the applicant, Water Service Corporation of Kentucky (Water Service), and the intervenor, Attorney General of the Commonwealth of Kentucky to express their agreement on a mutually satisfactory resolution of all of the issues in the instant proceeding which shall hereafter be referred to as the "Stipulation" and/or "Recommendation".

It is understood by all parties hereto that this Recommendation is not binding upon the Public Service Commission ("Commission"), nor does it represent agreement on any specific theory supporting the appropriateness of any recommended adjustments to Water Service's rates. The parties have expended considerable efforts to reach the stipulation and agreements that form the basis of this Recommendation. The parties, representing diverse interests and divergent viewpoints, agree that this Recommendation, viewed in its entirety, constitutes a reasonable resolution of all issues in this proceeding.

In addition, the adoption of this Recommendation will eliminate the need for the Commission and the parties to expend significant resources in litigation of this proceeding, and eliminate the possibility of, and any need for, rehearing or appeals of the Commission's final order. Based upon the parties' participation in settlement conferences and the materials on file with the Commission, and upon the belief that these materials adequately support this Stipulation and Recommendation, the parties stipulate and recommend the following:

1. Water Service should be permitted to adjust its rates to recover more in annual revenue than it is recovering under its current rates, with such rates to be effective for service rendered on and after the date of PSC approval of this Stipulation and Recommendation. The parties agree to a recommended reduction of \$371,441.00 from the original revenue increase amount of \$825,423.00 for an amended annual revenue increase amount of \$453,982.00, which is an increase in annual revenue of 33.1%. This increase will be recovered by an equal adjustment to each of the of the current rate blocks for Clinton and Middlesboro.

2. Water Service's proposed tariff and rate design revisions as reflected in its original application are withdrawn.

3. Each party waives all cross-examination of the witnesses of the other parties unless the Commission disapproves this Recommendation, and each party further stipulates and recommends that the Notice of Intent, Notice of Application, testimony, pleadings and responses to data requests filed in this proceeding be admitted into the record.

4. This Recommendation is submitted for purposes of this case only and is not deemed binding upon the parties in any other proceeding, nor is it to be offered or relied upon in any other proceeding involving Water Service or any other utility.

5. If the Commission issues an order adopting this Recommendation in its entirety, each of the parties agrees that it shall file neither an application for rehearing with the Commission, nor an appeal to the Franklin County Circuit Court with respect to that order.

6. If this Recommendation is not adopted in its entirety, each party reserves the right to withdraw from it and require that hearings go forward upon any or all matters involved, and that in such event the terms of this Recommendation shall not be deemed binding upon the

parties, nor shall such Recommendation be admitted into evidence, or referred to, or relied upon in any manner by any party, the Commission, or its Staff in any such hearing.

7. The parties agree that the foregoing Recommendation is reasonable and in the best interests of all concerned, and urge the Commission to adopt the Recommendation in its entirety.

AGREED: this 29~~th~~ day of August, 2006.

WATER SERVICE CORPORATION  
OF KENTUCKY

BY:   
JOHN N. HUGHES, ITS ATTORNEY

KENTUCKY ATTORNEY GENERAL

BY:   
DAVID EDWARD SPENARD, ASSISTANT  
ATTORNEY GENERAL

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 2005-00325 February 28, 2007.

Middlesboro Rates

Industrial City Special	\$ 98.44
Commercial City Sprinkler	\$ 15.00
Industrial City Sprinkler	\$ 15.00
Commercial City Special	\$ 30.00
Commercial County Special	\$ 45.00
Commercial County Special	\$ 315.00
Government City Special	\$ 30.00
Government City Special	\$ 105.00
Commercial City Special	\$ 45.00
Commercial City Special	\$ 60.00
Industrial City Sprinkler	\$ 60.00
Industrial City Special	\$ 75.00
Government City Hydrant	\$ 3.33 /hydrant

Clinton Rates

Hydrant (private)	\$ 7.50
5/8" sprinkler (private)	\$ 15.00
Hydrant (municipal)	\$ 3.33 /hydrant

APPENDIX C

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
 COMMISSION IN CASE NO. 2005-00325 DATED February 28, 2007.

The following rates and charges are prescribed for the customers in the area served by Water Service Corporation of Kentucky. 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 Water Rates

Middlesboro

Consumption

First	1,000 gallons	\$6.74	Minimum bill
Next	9,000 gallons	2.71	per 1,000 gallons
Next	15,000 gallons	2.47	per 1,000 gallons
Next	25,000 gallons	2.35	per 1,000 gallons
Next	50,000 gallons	2.10	per 1,000 gallons
All Over	100,000 gallons	1.92	per 1,000 gallons

Minimum Monthly Charge

5/8" or 3/4" Meter	\$ 6.74	1,000 gallons
1" Meter	20.29	6,000 gallons
1 1/2" Meter	38.54	13,000 gallons
2" Meter	59.29	21,400 gallons
3" Meter	165.57	68,400 gallons
4" Meter	284.73	127,500 gallons
6" Meter	580.41	281,500 gallons

Clinton

Consumption

First	1,000 gallons	\$9.02	Minimum bill
Next	9,000 gallons	5.11	per 1,000 gallons
Next	15,000 gallons	4.69	per 1,000 gallons
Next	25,000 gallons	4.27	per 1,000 gallons
Next	50,000 gallons	3.79	per 1,000 gallons
All Over	100,000 gallons	3.31	per 1,000 gallons

Minimum Monthly Charge

5/8" or 3/4" Meter	\$ 9.02	1,000 gallons
1" Meter	30.99	5,300 gallons
1 1/2" Meter	60.64	11,200 gallons
2" Meter	90.65	17,600 gallons
3" Meter	262.05	57,900 gallons
4" Meter	423.93	100,700 gallons
6" Meter	919.77	250,500 gallons

Monthly Fire Protection Charges

Private Hydrants or Sprinkler Systems	\$ 15.00 per hydrant or sprinkler
Clinton municipally owned hydrants	3.33 per hydrant
Middlesboro municipally owned hydrants	3.33 per hydrant