

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE TARIFF FILING OF NORTH SHELBY WATER)
COMPANY TO REVISE ITS EXTENSION POLICY TO) CASE NO. 2005-00327
INCLUDE A LINE UPSIZE CHARGE)

ORDER

North Shelby Water Company ("North Shelby") has applied for authority to continue assessing its Line Upsize Charge ("LUC")¹ for an additional 10-years, or until December 31, 2015. This application presents the following issue: Do the conditions under which North Shelby presently operates and expects to operate in the next 10 years make the continued assessment of the charge reasonable? Finding in the negative, the Commission denies the application.²

¹ In its application, North Shelby refers to the charge as a "Line Upsize Charge." When the Commission originally considered the charge in Case No. 1995-00161, North Shelby termed the charge as a "Line Enlargement Charge." In its filed rate schedules, North Shelby also refers to the charge as a "Line Enlargement Charge." See Tariff of North Shelby Water Company, P.S.C. Ky. No. 2, First Amended Sheet No. 19. To avoid confusion, the Commission's references in this Order to "Line Upsize Charge" include the "Line Enlargement Charge."

² North Shelby filed its application with the Commission on August 8, 2005. It subsequently amended its application on August 15, 2005. On December 22, 2005, the Commission authorized North Shelby to continue collection of the LUC, subject to refund, pending a final decision in this proceeding.

No persons have moved for intervention in this proceeding. No hearing has been requested or held in this matter. The Commission, through Commission Staff, has issued information requests to North Shelby regarding the proposed extension of the LUC. North Shelby's application and its responses to these requests constitute the record of this proceeding. Additionally, the Commission has incorporated by reference the record of Case No. 1995-00161 and North Shelby's annual reports for the years from 1995 to 2005 into the record of this proceeding.

North Shelby, a non-profit corporation organized pursuant to KRS Chapter 273, owns and operates a water distribution system that furnishes water service to approximately 4,548 customers in the Kentucky counties of Franklin, Henry, Jefferson, Oldham and Shelby.³ It is a utility that is subject to the Commission's jurisdiction. KRS 278.010(3)(d); 278.012; KRS 278.040.

In Case No. 1995-00161,⁴ the Commission approved proposed revisions to North Shelby's water main extension policy that permitted the water utility to assess an LUC. The policy requires a developer who is subdividing real estate parcels that are 50 acres or less,⁵ and that North Shelby's water mains presently serve, to pay a charge equal to one-half the average cost of installing a 6-inch water distribution main across the road frontage of the real estate parcel. The charge is assessed only in those instances where the water utility's existing water mains are adequate to meet the demand that the new real estate development presents.

In its order approving the proposed policy, the Commission made no specific findings regarding the need for the LUC or its reasonableness. Noting only that the LUC "is a novel tariff provision tailored by the applicant to the specific facts of its situation and is of a type which has not regularly been approved by the Commission," the Commission approved the charge for a 10-year period beginning January 1, 1996

³ Annual Report of North Shelby Water Company to the Public Service Commission for the Calendar Year Ended December 31, 2005 at 5 and 27.

⁴ North Shelby Water Company, Case No. 1995-00161 (Ky.PSC Sep. 25, 1995).

⁵ North Shelby's policy originally applied to lots that were 15 acres or less. North Shelby subsequently amended to the policy to apply to lots 50 acres or less.

and directed North Shelby to “be prepared to demonstrate. . . the appropriateness of the charge.”⁶

Emphasizing the unique nature of the LUC, the Commission imposed conditions upon the use of the proceeds from the charge. It ordered North Shelby to place all LUC proceeds into an escrow account to be used for enlarging distribution lines or, when more practical, for the installation of connections between water mains. It further directed the utility to file certain information about the LUC with its annual report.⁷

In presenting its proposal to the Commission, North Shelby argued that the LUC was necessary to meet the changing customer demand. It asserted that its water distribution system was originally designed to serve primarily farms and sparsely populated rural areas. Population migration from urban areas and the development of agricultural land for residential purposes was creating stress upon its water distribution system and would require the replacement of its existing 2-inch and 3-inch water mains. It noted in its application:

Approximately 416,000 linear feet of 3 inch line and more than 42,000 linear feet of 2 inch line exists in our current distribution system. These lines are obviously inadequate to serve concentrated residential development. In addition to the . . . [two] and three inch lines, we have even more four inch line on our system which will eventually become obsolete or inadequate if current trends continue.⁸

⁶ North Shelby Water Company, Case No. 1995-00161 (Ky.PSC Sep. 25, 1995) at 2.

⁷ This information included a prioritized list of proposed projects, the estimated cost of each project, the list and cost of projects completed during the year, the amount of LUC revenues collected from developers during the year, the individual expenditures, and the balance of funds remaining in the escrow account.

⁸ North Shelby Water Company, Case No. 1995-00161, Application at 2.

North Shelby asserted that the cost of infrastructure replacement and improvement necessary to serve the expected new residential growth would place significant pressure on rates for water service and require significant rate adjustments. It argued that the LUC would more equitably place these costs on developers who otherwise would not pay for the effects of their development.⁹

The record shows that the significant growth and significant infrastructure replacement that was anticipated has not occurred. During the past 10 years, North Shelby has experienced an annual growth rate of approximately 3 percent.¹⁰ It has replaced approximately 20,000 linear feet of 2-inch water main and 11,500 linear feet of 3-inch water main.¹¹

The record further shows that the accumulated funds from the LUC have not been readily expended. As of August 15, 2005, North Shelby had collected proceeds and interest from the LUC totaling \$621,509. It had expended \$312,920,¹² or approximately 50.3 percent of total proceeds and interest, leaving \$308,589.

⁹ North Shelby Water Company, Case No. 1995-00161, Transcript of Hearing at 29 – 33.

¹⁰ This growth rate is obtained by a comparison of North Shelby's year-end customer levels as reported annually to the Commission in North Shelby's annual reports for the years from 1995 to 2005. The Commission incorporates by reference these reports into the record of this proceeding.

¹¹ North Shelby's Amended Motion at 2.

¹² The expended funds were for the following projects:

Harrington Mill Upgrade	\$ 34,010
Mulberry Loop	47,183
Aiken Road Upgrade	68,300
Drane Lane Loop	54,618
Bob Rogers Loop	34,762
Trammell Lane Loop	74,047
Total	\$312,920

Although only 7 percent of North Shelby's 2- and 3-inch water mains have been replaced since the LUC has been in effect, North Shelby argues that the LUC "worked effectively and fairly in avoiding the transfer of line enlargement costs from profit-making developers to rate-paying customers."¹³ It states that LUC funds have also been used to replace 4-inch water mains and to reinforce stretches of 2- and 3-inch water mains by completing 4 loop projects. North Shelby asserts that the LUC was never intended nor designed to replace all of 2- and 3-inch water mains. It states that the remaining proceeds and interest will be used on the next major infrastructure project that it estimates to cost \$2.4 million.¹⁴

The record appears to indicate that much of the current infrastructure replacement that the LUC was intended to fund could be funded through North Shelby's general rates without significant increases. A utility's rates generally contain a component for depreciation to provide funds to make ordinary renewals and replacements of facilities.¹⁵ From 1995 through 2004 North Shelby charged against revenues depreciation expense in the total amount of \$2,057,569. The level of ordinary extensions North Shelby funded through general rates from 1995 through 1999 is unknown, but for the period from 2000 through 2004 it expended \$15,442 from general

¹³ North Shelby's Amended Motion at 2.

¹⁴ This project is not dependent upon the LUC proceeds. North Shelby states that funding will be provided through a variety of sources including internally generated funds, borrowed funds, and grants. There is currently no definite construction timetable for the project. See North Shelby's Response to Commission Staff's Second Information Request, Item 2.

¹⁵ Public Service Commission of Kentucky v. DeWitt Water District, 720 S.W. 2d 725 (Ky. 1986).

rate revenue on normal extensions and replacements.¹⁶ From 1995 through 2004 North Shelby funded approximately \$312,920 in improvements to its water distribution through the LUC. The depreciation component of North Shelby's general rates appears quite adequate to fund the LUC-funded improvements.

Furthermore, the record does not indicate that population shifts and increasing residential development are creating significant pressure for rate adjustments. In the last 10 years, North Shelby has adjusted its rates 6 times to reflect the higher cost of water purchased from its supplier. It, however, has not adjusted its general rates during this period. Despite the lack of a general rate adjustment during this period, North Shelby financed two major construction projects in the amounts of \$1,120,800¹⁷ and \$1,153,900.¹⁸

In addition to the absence of compelling evidence to suggest that the LUC is necessary, the Commission finds significant evidence that North Shelby has poorly administered LUC funds. It has failed to file the required reports on LUC collections in a timely and complete manner. Its report for calendar year 1996 was incomplete. It failed to file its reports for calendar years 1997 through 2000 in a timely manner and made such filings only after Commission Staff made repeated inquiries. It filed no report for calendar years 2001 and 2002. It filed incomplete reports for calendar years 2003 and 2004.

¹⁶ North Shelby's Response to Commission Staff's First Information Request, Item 9(a).

¹⁷ North Shelby Water Company, Case No. 2000-00046 (Ky.PSC Feb. 23, 2000).

¹⁸ North Shelby Water Company, Case No. 1998-00476 (Ky.PSC Sep. 11, 1998).

Given these concerns, the Commission finds insufficient evidence to support continuation of the LUC. The record fails to indicate a continuing need for the charge or significantly high levels of customer growth that require the use of alternative rate-making mechanisms. Accordingly, the Commission finds that North Shelby's application for authority to continue assessing the LUC should be denied.

In rendering this decision, the Commission does not wish to minimize the possible effects of significant customer growth and the corresponding need for significant infrastructure improvements or additions. Should North Shelby experience such growth, it should consider the assessment of a system development charge¹⁹ to ensure that costs of such growth are fairly and equitably distributed among its customers.

IT IS THEREFORE ORDERED that:

1. North Shelby's application for authority to continue assessing the LUC should be denied.
2. As of the date of this Order, North Shelby shall cease collecting its LUC.
3. Within 30 days of the date of this Order, North Shelby shall refund all LUC charges collected since on and after January 1, 2006.
4. Within 60 days of the date of this Order, North Shelby shall file with the Commission a written report in which it advises of the amount refunded.
5. As to all LUC funds that were collected prior to January 1, 2006 and that have yet to be expended, North Shelby shall continue to comply with the provisions of the Commission's Order of September 25, 1995 in Case No. 1995-00161 regarding the funds' use and accounting and the reporting of its use.

¹⁹ See 807 KAR 5:090.

Done at Frankfort, Kentucky, this 7th day of June, 2006.

By the Commission

ATTEST:

Executive Director