

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

RATE ADJUSTMENT OF KENTON)
COUNTY WATER DISTRICT) CASE NO. 8572

O R D E R

On September 30, 1982, Kenton County Water District ("Kenton County") filed its notice with this Commission to increase its rates effective October 21, 1982. The proposed rates would increase revenue by \$1,369,045 annually, an increase of 32 percent. Based on the determination herein, the revenues of Kenton County will increase by \$904,073 annually, an increase of 21 percent.

On October 1, 1982, the Commission suspended the proposed rate increase until March 21, 1983, in order to conduct public hearings and investigations into the reasonableness of the proposed rates. A public meeting to receive public comment and testimony was conducted on December 7, 1982, in the City/County Building, Covington, Kentucky. A hearing for the purpose of cross-examination of Kenton County's witnesses was held in the Commission's offices in Frankfort, Kentucky, on January 26, 1983, with all the parties of record represented.

Motions to intervene in this matter were filed by the Consumer Protection Division in the Office of the Attorney General and the City of Florence.

Commentary

Kenton County is a nonprofit water distribution system organized and existing under the laws of the Commonwealth of Kentucky, and serves approximately 29,080 customers in Kenton County.

Test Period

Kenton County proposed and the Commission has accepted the 12-month period ending June 30, 1982, as the test period for determining the reasonableness of the proposed rates. In utilizing the historic test period, the Commission has given full consideration to appropriate known and measurable changes.

Net Investment

Kenton County proposed a net investment rate base of \$23,227,981. The Commission has adjusted the rate base to reflect the accepted pro forma adjustments to operation and maintenance expenses in the calculation of the allowance for working capital. The rate base has further been increased by \$3,315 to include prepayments.

All other elements of the net original cost rate base have been accepted as proposed by Kenton County.

Therefore, the Commission has determined Kenton County's net investment rate base to be as follows:

Utility Plant in Service	\$28,656,198
Construction Work in Progress	124,256
Prepayments	3,315
Materials and Supplies	87,523
Cash Working Capital	417,206
Sub-total	<u>\$29,288,498</u>

Less:	
Reserve for Depreciation	\$ 3,986,505
Contributions in Aid of Construction	2,045,016
Sub-total	<u>\$ 6,031,521</u>
Net Original Cost Rate Base	<u><u>\$23,256,977</u></u>

Revenues and Expenses

On Exhibit 10 of the application, Kenton County proposed adjustments to test year operating revenue and expense. The Commission is of the opinion that the proposed adjustments are generally proper and acceptable for rate-making purposes with the following modifications:

Sales to City of Walton

Kenton County proposed an adjustment to increase revenue by \$33,922 to reflect the projected additional sales to the City of Walton, Kentucky ("Walton"). Walton became a wholesale customer of Kenton County during the last month of the test year with only 5 days of actual usage or 96,417 cubic feet reflected in the test year sales volume. In determining the proposed adjustment, Kenton County annualized the sales volume for the months of July and August of 1982 and applied the rate charged during the test year. Since the bills for the months of June through December are available as a part of the record in this case, the Commission finds it more appropriate to annualize the sales to Walton based on the actual billing for the 6-month period rather than the 2 months proposed by Kenton County. This results in an adjusted sales volume of 6,787,290 cubic feet. Based on Kenton

County's wholesale water rates, this level of sales will generate \$30,066 in annual revenue.

Maintenance of Mains

A. Leak Repairs

During the test year, Kenton County incurred \$25,897 in leak repairs at its Howard Avenue treatment plant. The amount of this repair was included in Account 673, Maintenance of Transmission and Distribution Mains, for the test year. Mr. Malvern Connett, witness for Kenton County, stated that this was an extraordinary repair.^{1/} Therefore, the Commission finds that this cost should be amortized over a 5-year period since the cost cannot reasonably be expected to recur on an annual basis. This results in an increase of \$5,179 to amortization expense and a reduction of \$25,897 to Account 673.

B. Excavating, Cleaning and Raising Water Valves

During the test year Kenton County incurred \$9,273 for excavating, cleaning and raising water valves which was included in Account 673, Maintenance of Transmission and Distribution Mains. These costs were incurred as a result of a state highway project in the city of Covington where the streets were resurfaced.^{2/} The Commission finds that this expenditure is an extraordinary expense which cannot reasonably be expected to

^{1/} Transcript of Evidence ("T.E."), January 26, 1983, pages 124-5.

^{2/} Ibid., page 118.

recur on an annual basis, and should be amortized over a reasonable period of time. Therefore, the Commission has reduced Account 673 by \$9,273 for rate-making purposes. In addition, the Commission has increased amortization expense by \$1,855 to reflect a 5-year amortization of the total cost.

Depreciation

The depreciation schedule submitted by Kenton County reflects that depreciation expense for the test period was based on the total utility plant in service of \$28,656,198. It is the policy of the Commission to compute depreciation expense for rate-making purposes on the basis of the original cost of the plant in service less contributions in aid of construction. The Commission has determined that contributions in aid of construction represent approximately 7.1 percent of the total cost of utility plant in service. Therefore, depreciation expense has been reduced by \$38,417 for the test period to exclude depreciation on assets purchased with contributions in aid of construction.

Hospitalization Cost

Kenton County proposed an increase in test year expense of \$10,670 to reflect the increase in hospitalization insurance rates effective July 1, 1982. In determining the adjustment, Kenton County rounded the ratio of capitalized payroll to total payroll from 3.32 percent to 3 percent, and also rounded the actual calculation of increased hospitalization costs from \$11,565 to \$11,000. The Commission is of the opinion that it is more appropriate to

use the actual experience rate for capitalizing payroll related expenses as well as the actual calculated increase in hospitalization costs. This results in an increase to test year expenses of \$11,181.

Salary and Wages

Kenton County proposed an increase of \$30,684 to salary and wage expense to reflect a 6 percent wage increase effective January 1, 1982. In determining the amount of the adjustment, Kenton County applied the 6 percent increase to the salary and wages for the first 6 months of the test period. However, this generated an amount greater than the increased cost actually reflected in the latter 6 months of the test period with the increase in effect. Since Kenton County provided no conclusive evidence as to the reason for the difference between the two amounts, the Commission finds it more appropriate to divide the gross salary and wages in half and then apply the actual increase of 6 percent to determine a normalized adjustment for rate-making purposes.

Included in the gross salary and wages for the test period was the salary for the general manager, Mr. Victor Fender. However, no increase was granted for Mr. Fender either during the test year or subsequent thereto.^{3/} Therefore, the Commission has

^{3/} T.E., January 26, 1983, page 29.

excluded his salary from test year salary and wages in determining the normalized adjustment. This results in an increase to total actual salary and wages of \$29,944.^{4/}

Kenton County further proposed an increase of \$62,528 to salary and wage expense to reflect an anticipated wage increase of 6 percent effective January 1, 1983. In determining the adjustment, Kenton County applied the 6 percent increase to the test year actual salary and wages. The Commission is of the opinion that the adjustment would more accurately reflect the future cost of wages and salaries if the increase granted on January 1, 1983, of 5 percent is applied to the normalized wages in determining the adjustment. This results in an increase to total salary and wages of \$51,404.

After reducing the total adjusted salary and wages by capitalized wages based on the ratio allowed herein, test year salary and wage expense will increase by \$78,647.

Payroll Expenses

Kenton County proposed an adjustment of \$23,074 to increase payroll expenses that resulted from the salary and wage increases requested herein. The Commission has reduced Kenton County's proposed adjustment to reflect the amount of wages and capitalization ratio allowed herein. This results in an increase to test year expenses of \$20,969.

^{4/} $\$1,042,134 - \$44,000 = \$998,134 + 2 \times 6\% = \$29,944.$

Water Treatment Expenses

Kenton County proposed an adjustment to increase water treatment expenses by \$6,619 to reflect additional expenses associated with the increased sales to Walton. In determining the proposed adjustment, Kenton County divided the actual treatment expenses by the actual volume of sales during the test period plus the projected sales to Walton to determine the cost per cubic foot. This was then applied to the estimated additional sales volume to Walton to determine the additional water treatment expenses. The Commission finds it more appropriate to use the actual water produced during the test year in determining the cost per cubic foot. In determining a normal level of water produced in the test year, the Commission has divided the sales during the test year by the weighted average ratio of water sold to water produced for the last 3 calendar years.^{5/} The Commission has further adjusted Kenton County's proposed adjustment to reflect the sales to Walton allowed herein. This results in an increase to actual water treatment expenses of \$4,342.^{6/}

Pumping Expenses

Kenton County proposed an adjustment to increase pumping expenses by \$9,515 to reflect the additional expenses associated

$$\frac{5/ \text{ Actual sales } = 7,554,129}{.8149} = \frac{9,270,007}{.8149}$$

$$\begin{aligned} 6/ \text{ Actual treatment expenses } &= \frac{\$601,798}{9,270,007} = \$.0649 \\ \$.0649 \times 66,908.9 \text{ (Walton increased sales)} &= \$4,342 \end{aligned}$$

with the increased sales to Walton. In determining the proposed adjustment, Kenton County divided the actual pumping expenses exclusive of distribution expense by a sales volume consisting of test year actual sales and projected sales to Walton to determine the cost per cubic foot. This cost was then applied to the increased estimated volume of sales to Walton to determine the additional pumping expenses. The Commission finds it more appropriate to use the normalized pumping expenses exclusive of distribution expenses for the test year rather than the actual expenses in the calculation. Further, the Commission finds that the estimated water produced as calculated in the previous section should be used to determine the cost per cubic foot. This results in an adjusted increase to pumping expenses of \$6,738 based on the volume of sales to Walton accepted herein.^{7/}

The Commission finds that Kenton County's adjusted test period operating income is as follows:

	<u>Actual Test Period</u>	<u>Pro Forma Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$4,359,028	\$ 30,066	\$4,389,094
Operating Expenses	<u>3,702,851</u>	<u>179,262</u>	<u>3,882,113</u>
Operating Income	\$ <u>656,177</u>	<u>\$(149,196)</u>	\$ <u>506,981</u>

Revenue Requirements

Kenton County's proposed rates were designed to produce revenue sufficient to provide a debt service coverage of 1.2

7/ Normalized pumping expenses - Distribution expenses =
Estimated water produced
 $\frac{\$1,294,536 - \$361,001}{9,270,007} = \$0.1007$
 $\$0.1007 \times 66,908.9 \text{ (Walton increased sales)} = \$6,738$

based on the maximum annual principal and interest on the bond issue of 1981. However, in determining the revenue requirements Kenton County did not reflect the interest income earned of \$14,751 on the general revenue fund-customer guarantee, of \$13,232 on the improvement, repair and replacement fund, of \$27,426 on the plant fund and \$267,926 on the debt service reserve fund because the use of the income was restricted. Kenton County, however, did not provide conclusive evidence in support of excluding this interest income for purposes of calculating the revenue requirements. Further, the bond resolution does not specifically state that the interest income earned on these funds cannot be utilized for purposes of calculating the revenue requirements provided from rates. Therefore, the Commission has decreased operating revenue requirements by the total actual interest income earned for the test year of \$508,242. The Commission has determined that additional revenue of \$904,073 is necessary to provide the 1.2 debt service coverage which will be sufficient to allow Kenton County to pay its operating expenses and meet its debt service requirements. This results in a 6.1 percent rate of return on the net original cost rate base established herein.

Rate Design

The City of Ludlow, Kentucky, ("City") and several other municipal customers of Kenton County commented at the public meeting held December 7, 1982, concerning a prior Commission decision abrogating their water purchase contracts. The City's witnesses also testified at the hearing held January 26, 1983, about the prior contract and requested that the prior contract

rate be reinstated and a refund be issued to cover the period since the contract rate has been changed.

In Utility Regulatory Commission ("URC") Case No. 7794, Kenton County applied for a rate increase, including an increase in wholesale rates for the cities of Florence, Independence, Cold Spring, Taylor Mill and Ludlow. All of the cities, except Independence, intervened in the case. The URC approved increased rates from 17.4 cents to 38 cents on August 29, 1980, thereby abrogating the contract which previously existed between Kenton County and the cities. KRS 278.200 expressly granted the Commission the power to abrogate contracts, as the following provision indicates:

The commission may, under the provisions of this chapter, originate, establish, change, promulgate and enforce any rate or service standard of any utility that has been . . . fixed by any contract . . . between the utility and any city, and all rights, privileges and obligations arising out of any such contract . . . shall be subject to the jurisdiction and supervision of the commission, . . .

In 1936, the Kentucky Supreme Court upheld KRS 278.200 as constitutional in Southern Bell Telephone and Telegraph Co. v. City of Louisville, Ky., 96 S.W.2d 695 (1936). In that same year, the United States Supreme Court upheld a similar statute enacted by the Missouri legislature and the decision of that state's public service commission authorizing the utility to charge higher rates than the rates specified in a contract in Midland Realty Co. v. Kansas City Power and Light, 300 U.S. 190, 81 L.ed. 540, 544 (1936).

The PSC is required to set fair, just and reasonable rates and in so doing the PSC must balance the interests of the utility and its customers. Under that proviso, the former URC determined that the fair, just and reasonable rate to be charged the cities was 38 cents per 100 cubic feet in Case No. 7794. Likewise, the Commission was required to consider KRS 278.170(1) which provides:

No utility shall, as to rates or service, give any unreasonable preference or advantage to any person or subject any person to any unreasonable prejudice or disadvantage, or establish or maintain any unreasonable difference between localities or between classes of service for doing a like and contemporaneous service under the same or substantially the same conditions.

None of the cities filed a timely appeal of the Order in Case No. 7794 in Franklin Circuit Court within 20 days as required by KRS 278.410. On April 22, 1981, the City of Ludlow filed a complaint in Kenton Circuit Court challenging the Commission's decision. The Commission responded by filing a Motion to Dismiss for lack of jurisdiction since KRS 278.410 grants exclusive jurisdiction to the Franklin Circuit Court over Commission appeals and because the matter was now res judicata. The Kenton Circuit Court granted the Commission's motion and the City of Ludlow filed a notice of appeal. However, the City failed to perfect its appeal and the Court of Appeals dismissed it on January 25, 1982. Thus, the City of Ludlow is prevented by res judicata from seeking reinstatement of the contract rate and refund in this proceeding based upon the assertion that the Commission illegally abrogated the previous contract rate.

In the instant case, Kenton County did not propose to change the rate structure now in effect. The Commission is of the opinion that in the absence of a cost of service study, it would not be in the best interest of the public nor Kenton County to initiate a new rate design. Therefore, the rate increase granted herein has been spread to the existing rate structure so that the percentage of revenue from general customers and revenue from water sold for resale remains the same as established in prior cases.

Summary

The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that:

1) The rates in Appendix A are fair, just and reasonable rates for Kenton County in that they will produce annual operating revenues of approximately \$5,293,167 including other operating revenue of \$110,363 and should be approved. These revenues will be sufficient to meet Kenton County's operating expenses found reasonable for rate-making purposes, service its debt and provide a reasonable surplus.

2) The rates proposed by Kenton County would produce revenue in excess of that found reasonable herein and should be denied.

IT IS THEREFORE ORDERED that the rates in Appendix A be and they hereby are approved for service rendered by Kenton County on and after March 21, 1983.

IT IS FURTHER ORDERED that the rates proposed by Kenton County be and they hereby are denied.

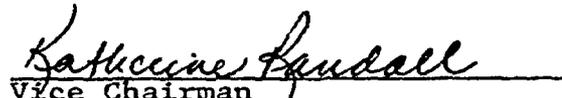
IT IS FURTHER ORDERED that within 30 days from the date of this Order Kenton County shall file with this Commission its revised tariff sheets setting out the rates approved herein.

IT IS FURTHER ORDERED that the City's request for reinstatement and refund based on the previous rate be denied.

Done at Frankfort, Kentucky, this 22nd day of March, 1983.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION IN CASE NO. 8572 DATED MARCH 22, 1983

The following rates and charges are prescribed for the customers in the area served by Kenton County Water District No. 1. 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 date of this Order.

General Rates Quarterly - to be charged in all service area

First	600 Cubic Feet used per quarter	\$6.00 Minimum
Next	4,400 Cubic Feet used per quarter	0.83 per 100 Cu. Ft.
Next	495,000 Cubic Feet used per quarter	0.73 per 100 Cu. Ft.
Next	1,500,000 Cubic Feet used per quarter	0.60 per 100 Cu. Ft.
All Over	2,000,000 Cubic Feet used per quarter	0.45 per 100 Cu. Ft.

Wholesale Rates

The City of Florence, Kentucky, Boone County Water District, the City of Independence, Kentucky, the City of Cold Spring, Kentucky, Taylor Mill Water Commission, and the City of Walton, Kentucky, shall be charged the following rate:

All water purchased (Cu. Ft.) @ \$0.48 per 100 Cu. Ft.

The City of Bromley, Kentucky, the City of Ludlow, Kentucky, Campbell County Water District No. 3, and Winston Park Water Department, shall be charged the following rate:

All water purchased (Cu. Ft.) @ \$0.45 per 100 Cu. Ft.

Tapping Fee Schedule

5/8" Service Installation	\$225.00
3/4" Service Installation	260.00
1" Service Installation	325.00
1 1/2" Service Installation	500.00
2" Service Installation	600.00

All Service Over 2" at actual cost plus 10%.