

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

APPLICATION OF MARION COUNTY WATER)
DISTRICT FOR: (1) A CERTIFICATE OF)
PUBLIC CONVENIENCE AND NECESSITY TO)
CONSTRUCT EXTENSIONS AS DESCRIBED;)
(2) AUTHORITY TO BORROW APPROXI-) CASE NO. 9384
MATELY \$431,000 FROM FARMERS HOME)
ADMINISTRATION; (3) A RATE INCREASE)
EFFECTIVE AUGUST 1, 1985)

O R D E R

The Marion County Water District ("Marion County"), by application filed July 11, 1985, and revised during the proceedings in this matter, is seeking approval to increase its water service rates, authorization to construct a \$725,000 waterworks project, and approval of its financing for the proposed project. The project financing includes \$14,000 from applicants for service in the proposed project area, a loan of \$431,000 from the Farmers Home Administration ("FmHA") and a grant of \$280,000 from the FmHA. The FmHA loan will be secured by waterworks revenue bonds maturing over a 40-year period at an interest rate of 7 3/4 percent per annum.

The proposed construction will replace the water system now serving the City of Bradfordsville and provide water service to about 55 additional applicants for service. As a result of this construction Marion County will be providing water service

to about 206 additional customers. Plans and specifications for the construction prepared by Howard K. Bell, Consulting Engineers, Inc., of Lexington, Kentucky, ("Engineers") have been approved by the Division of Water of the Natural Resources and Environmental Protection Cabinet.

A hearing was held in the offices of the Public Service Commission, Frankfort, Kentucky, on March 18, 1986. There were no intervenors present and no protests were entered.

Marion County requested rates which would produce an annual increase of \$35,429. In this Order, the Commission has allowed rates which will produce an annual increase of \$18,046.

TEST PERIOD

Marion County proposed and the Commission has accepted the 12-month period ending April 30, 1985, as the test period in this matter.

REVENUES AND EXPENSES

Marion County reported a net operating income of \$63,332 for the test period and proposed several pro forma adjustments for an adjusted net operating income of \$49,848. The Commission upon reviewing Marion County's pro forma revenues and expenses has made the following adjustments in order to reflect expected operating conditions:

Transmission and Distribution

Marion County proposed a pro forma adjustment of \$8,874 to test-period transmission and distribution expense consisting of the following: (1) an adjustment of \$2,774 to annualize wage

increases granted during the test period and (2) an adjustment of \$6,100 based on the average of the percentage increase in customers and cost of plant.

At the hearing Mr. Starling Gregory, Corporate Secretary-Treasurer and economist for Howard K. Bell, Consulting Engineers, Inc., testified that there are other variables which would affect the level of test-period transmission and distribution expense other than the two utilized in the pro forma calculation.¹ He further stated that the new construction would not warrant the same amount of maintenance as the older system would require.²

It has been the Commission's practice to allow only known and measurable pro forma adjustments for rate-making purposes. Considering the numerous variables which might effect the future level of transmission and distribution expense and that the new construction does not warrant the same level of cost as the old system, the Commission is of the opinion this adjustment does not meet the criteria of being either known or measurable. Therefore, the pro forma adjustment has been reduced by \$6,100 which results in a test-period adjusted level of \$28,423.

Customer Accounts

Marion County proposed a pro forma adjustment of \$5,397 to test-period customer accounts expense, consisting of the following: (1) an adjustment of \$1,897 to annualize wage increases granted during the test period and (2) an adjustment of \$3,500

¹Transcript of Evidence ("T.E."), March 20, 1986, page 29.

²T.E., page 30.

based on the percentage of increased customers. In its calculation Marion County utilized the entire customer accounts expense when it computed the additional cost due to the new customers. The Commission is of the opinion that since the wage increase was annualized that a calculation of this type would be duplicative. It is also the Commission's opinion that payroll expense is virtually fixed and not directly proportionate to the number of customers. Further the increase in customers is not of the magnitude which would require an increase in time requirements to warrant the hiring of additional employees or the need of additional wages to the current employees. The Commission has determined the appropriate adjustment to be \$3,093,³ a decrease of \$2,304 to Marion County's proposed adjustment for an adjusted level of \$32,422.

Insurance Expense

Marion County proposed a pro forma adjustment of \$1,659 to test-period insurance expense. Marion County based its adjustment on an anticipated 20 percent increase to insurance premiums. At the hearing the Commission requested copies of the insurance invoices received for 1986 and they were provided in the

³ Actual Customer Accounts Expense	\$29,329
Actual Wages paid	17,466
Non-wage expense	<u>\$11,863</u>
Percentage increase in Customers 191 + 1895	10.08%
Adjustment due to increase customers	<u>\$ 1,196</u>
Adjustment due to annualized wages	1,897
Commission Adjustment	<u><u>\$ 3,093</u></u>

responses filed March 20, 1986. Thus, the pro forma adjustment has been increased by \$2,733 for an adjusted level of \$12,686.

Rate Case Amortization

Marion County proposed a test-period rate case amortization expense of \$4,580 consisting of the following: (1) \$913 of a prior rate case amortization and (2) \$3,667 of the present rate case amortization. At the hearing Mr. Charles M. White, CPA and accountant for Marion County, stated that the \$913 of rate case amortization of a prior case should be removed from test-period operating expenses due to the fact that it was fully amortized by the end of 1985. The Commission concurs with Mr. White and has therefore reduced rate case amortization by \$913 for an adjusted level of \$3,667.

Depreciation Expense

Marion County proposed to increase its test-period depreciation expense of \$52,252 by \$14,494 to allow for depreciation on the proposed construction. It has been the practice of the Commission in previous decisions to compute depreciation expense for rate-making purposes on the basis of original cost of the plant in service less contributions in aid of construction, since a utility should not be allowed recovery of that portion of the plant which has been provided at zero costs. No new evidence was provided at or prior to the hearing which would change the Commission's position on this issue.

Marion County's test-period depreciation expense of \$52,252 reflects depreciation on the total existing plant using a

composite rate of approximately 2.19 percent.⁴ The balance sheet filed by Marion County shows contributions in aid of construction at the end of the test-period to be \$1,105,803. This amount is approximately 40.2 percent of the total cost of the existing utility plant in service. In determining the pro forma depreciation expense, the Commission has utilized the depreciation rate applied by Marion County and has excluded depreciation associated with contributed property. For rate-making purposes, the adjusted depreciation expense for the existing plant is \$28,255,⁵ a reduction of \$23,997 from test-period actual depreciation expense.

Marion County proposed depreciation expense of \$14,494 for the projected construction project using a composite rate of 2 percent. After eliminating the contributed property, the Commission has computed an adjusted depreciation expense for the projected construction of \$8,626.⁶ Therefore, Marion County's proposed depreciation expense of \$66,746 has been reduced by \$29,865 to arrive at the adjusted level of \$36,881.

$$^4 \$52,252 \div \$2,387,074 = 2.19\%$$

⁵ Total Existing Plant	\$2,396,005
Less: Contributions in Aid of Construction	<u>1,105,803</u>
Non-Contributed Existing Plant	<u>\$1,290,202</u>
Times: Composite Rate for Existing Plant	<u>2.19%</u>
Depreciation on Existing Plant Allowed for Rate-Making Purpose	\$ 28,255

⁶ Total Proposed Construction	\$725,000
Less: Contributions in Aid of Construction	<u>293,700</u>
Non-Contributed Proposed Construction	<u>\$431,300</u>
Times: Composite Rate for Proposed Construction	<u>2.00%</u>
Depreciation on Proposed Construction Allowed for Rate-Making Purposes	\$ 8,626

Therefore, Marion County's test-period operations have been adjusted as follows:

	Marion County's Proposed Adjusted	Commission Adjustments	Commission Adjusted
Operating Revenue:			
Metered Water Sales	\$377,484	-0-	\$377,484
Misc. Service Revenues	780	-0-	780
Total Operating Revenues	<u>\$378,264</u>	-0-	<u>\$378,264</u>
Operating Expenses	328,416	\$<36,449>	291,967
Operating Income	<u>\$ 49,848</u>	<u>\$ 36,449</u>	<u>\$ 86,297</u>

REVENUE REQUIREMENTS

Marion County's annual debt service based on debt outstanding during the test-period and debt proposed in this proceeding is \$111,232.⁷ Marion County's adjusted net operating income of \$86,297 plus interest income from operations of \$29,135 provides a debt service coverage ("DSC") of 1.04X. The Commission is of the opinion that this coverage is unfair, unjust and unreasonable. To achieve a DSC of 1.2X, which the Commission is of the opinion is the fair, just and reasonable coverage necessary for Marion County to pay its operating expenses and to meet the requirements of its lenders, Marion County would require a net operating income of \$143,478. Accordingly, the Commission has determined that additional revenue of \$18,046 is necessary to

⁷ Principal Existing Bonds (5-year Average)	\$ 19,400
Interest Existing Bonds (5-year Average)	57,400
Principal Proposed Bonds (5-year Average)	1,113
Interest Proposed Bonds (5-year Average)	33,319
Total Debt Service	<u>\$111,232</u>

provide the 1.2X DSC which will ensure the financial stability of Marion County.

FINDINGS AND ORDERS

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

1. Public convenience and necessity require that the construction proposed in the application and record be performed and that a certificate of public convenience and necessity be granted.

2. The proposed project for the Marion County water system includes 55 service connections, about 11.6 miles of 8-, 6-, 4- and 3-inch water main, a 160,000-gallon water storage tank and miscellaneous appurtenances. The low bids received for the proposed construction totaled \$567,419 which will require about \$725,000 in project funding after allowances are made for fees, contingencies, other indirect costs and additional construction being considered as a result of receiving bids under the final estimate.

3. Marion County should obtain approval from the Commission prior to performing any additional construction not expressly certificated by this Order.

4. Any deviations from the construction herein approved which could adversely affect service to any customer should be done only with the prior approval of this Commission.

5. Marion County should furnish duly verified documentation of the total costs of this project including the cost of

construction and all other capitalized costs (engineering, legal, administrative, etc.) within 60 days of the date that construction is substantially completed. Said construction costs should be classified into appropriate plant accounts in accordance with the Uniform System of Accounts for Water Utilities prescribed by this Commission.

6. Marion County's contract with its Engineer should require the provision of full-time resident inspection under the general supervision of a professional engineer with a Kentucky registration in civil or mechanical engineering to insure that the construction work is done in accordance with the contract plans and specifications and in conformance with the best practices of the construction trades involved in the project.

7. Marion County should require the Engineer to furnish a copy of the "as-built" drawings and a signed statement that the construction has been satisfactorily completed in accordance with the contract plans and specifications within 60 days of the date of substantial completion of this construction.

8. A 5/8-inch x 3/4-inch meter should be the standard customer service meter for all new customers and should be installed at all points of service unless the customer provides sufficient justification for the installation of a larger meter.

9. The financing plan proposed by Marion County is for lawful objects within the corporate purposes of its utility operations, is necessary and appropriate for and consistent with the proper performance of services to the public and will not

impair its ability to perform these services and should, therefore, be approved.

11. The rates proposed by Marion County will produce revenues in excess of the revenues found reasonable herein and should be denied upon application of KRS 278.030.

12. The rates and charges in Appendix A are the fair, just and reasonable rates to be charged by Marion County in that they should produce gross metered water revenues of \$395,530.

IT IS THEREFORE ORDERED that:

1. Marion County be and it hereby is granted a certificate of public convenience and necessity to proceed with the proposed construction project as set forth in the drawings and specifications of record herein.

2. Marion County's plan of financing consisting of applicant contributions in the amount of \$14,000, a loan from the FmHA in the amount of \$431,000 with an interest rate of 7 3/4 percent and a 40-year term and a grant from the FmHA in the amount of \$280,000 be and it hereby is approved.

3. If under new FmHA loan conditions Marion County is notified and granted the option of accepting a lower interest rate at the date of closing, Marion County shall file with the Commission the FmHA notification of the lower interest rate and shall provide all correspondence from and to FmHA concerning this notification within 30 days of the closing date.

4. Marion County shall file a statement of the interest rate accepted from FmHA within 30 days of the date of closing.

5. If Marion County accepts an interest rate different from the rate approved herein, it shall file amended pages to its bond resolution and an amended amortization schedule.

6. If Marion County is eligible but does not take advantage of a lower interest rate at the time of closing, it shall fully document why the lower rate was not accepted showing an analysis of the higher costs associated with the loan over its life.

7. Marion County shall comply with all matters set out in Findings 3 through 8 as if the same were individually so ordered.

8. The rates proposed by Marion County be and they hereby are denied.

9. The rates and charges in Appendix A be and they hereby are approved as the fair, just and reasonable rates and charges to be charged by Marion County for service rendered on and after the date of this Order.

Nothing contained herein shall be deemed a warranty of the Commonwealth of Kentucky, or any agency thereof, of the financing herein authorized.

Done at Frankfort, Kentucky, this 4th day of April, 1986.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 9384 DATED APRIL 4, 1986.

The following rates and charges are prescribed for customers receiving water service from Marion County Water District. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

Consumer Rates: Monthly

First 1,000 Gallons	\$7.60 Minimum Bill
Next 9,000 Gallons	1.67 per 1,000 Gallons
Next 90,000 Gallons	1.25 per 1,000 Gallons
All over 100,000 Gallons	1.00 per 1,000 Gallons

Minimum Monthly Charge:

5/8 or 3/4 Inch Meter	\$ 7.60
1 Inch Meter	12.00
2 Inch Meter	16.75