

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF THE SOUTH)
CUMBERLAND WATER DISTRICT, OF)
CUMBERLAND COUNTY, KENTUCKY,) CASE NO. 9411
FOR APPROVAL OF CONSTRUCTION,)
FINANCING, AND INCREASED)
WATER RATES)

O R D E R

The South Cumberland Water District ("South Cumberland") filed its application on August 28, 1985, for approval of adjustments to its water service rates, authorization to construct a \$1,005,500 waterworks improvement project and approval of its plan of financing for this project. The planned financing includes a \$655,000 grant from the Farmers Home Administration ("FmHA"), an FmHA loan of \$340,000, and a local contribution of \$10,500 from South Cumberland. The FmHA loan will be secured by waterworks revenue bonds maturing over a 40-year period at an interest rate of 7 percent per annum. The Commission has granted rates to produce an annual increase in revenues of \$22,876.

The proposed construction will improve hydraulic flow and service reliability to existing customers of South Cumberland and will provide service to approximately 80 additional customers northeast of Burkesville, Kentucky. Drawings and specifications for the proposed improvements prepared by W. F. Grier & Associates, Inc., of Lexington, Kentucky, ("Engineer") have been approved by the Division of Water of the Natural Resources and

Environmental Protection Cabinet. Construction bids were received on October 21, 1985, and November 12, 1985.

On December 19, 1985, an Order was entered which required certain additional information from South Cumberland to assist the Commission's review of the proposed construction. Upon receipt of this information, the Commission's engineering staff reviewed the project and in a Staff Report dated January 30, 1986, concluded that the proposed construction did not conform to generally accepted engineering practice. The report further concluded that while additional water storage was needed, a proposed second water storage tank located next to the existing tank could not be utilized effectively by the existing water system. The Staff Report was made part of the record in this case on January 30, 1986.

On January 31, 1986, an informal conference was held in the offices of the Public Service Commission between representatives of South Cumberland, its Engineer, FmHA, and Commission staff engineers. At the informal conference the Engineer proposed various design modifications to address the objections raised in the Staff Report. On February 5, 1986, additional technical information was filed.

A hearing was held in the offices of the Public Service Commission, in Frankfort, Kentucky, on February 26, 1986. No intervenors were present and no protests were entered. Additional information was requested from South Cumberland at the hearing and the requested information has been filed.

COMMENTARY ON THE HEARING

A Commission Staff Engineer testified that the proposed construction changes filed February 5, 1986, by South Cumberland's Engineer addressed the majority of the technical concerns raised in the Staff Report. He pointed out that the proposed operation of the pump station controls would cause a significant portion of the water distribution system to be subjected to operating pressures above its rated capacity. South Cumberland's Engineer agreed, and offered to redesign the pump control system to prevent it. South Cumberland's Engineer testified that he was aware of South Cumberland's large amount of unaccounted-for water of nearly 40 percent, and stated that he would commit "whatever time is necessary to find the leaks" in the water system.

TEST PERIOD

South Cumberland proposed and the Commission has accepted the 12-month period ending June 30, 1985, as the test period in this proceeding.

REVENUES AND EXPENSES

South Cumberland reported a net operating loss of \$9,240 for the test period. In order to recognize more normal operating conditions and the proposed expansion of the system, South Cumberland proposed in its filing several adjustments to test period expenses. The Commission finds the proposed adjustments acceptable for rate-making purposes, with the following exceptions:

Depreciation Expense

Test period depreciation expense reported by South Cumberland was \$28,120, reflecting total plant in service, resulting in a composite depreciation rate of approximately 2.5 percent.¹ For rate-making purposes the Commission generally allows depreciation only on that portion of plant, acquired through investment, and not on the plant acquired through contributions. Thus, in determining the reasonable depreciation expense, the Commission has excluded \$761,716 of plant representing South Cumberland's contributions in aid of construction at the end of the test period.

South Cumberland made no pro forma adjustments to depreciation expense to account for the plant expansion in this proceeding. Of the \$1,005,500 project proposed, \$340,000 will be financed by debt. Although South Cumberland made no adjustments, the Commission finds it reasonable to allow depreciation expense on the non-contributed portion of the expansion and has thus determined South Cumberland's depreciation expense for rate-making purposes to be \$17,664:

¹

Plant In Service 6/30/85	1,128,262
Depreciation Exp: test year	28,120
Depreciation Rate (28,120 ÷ 1,128,262)	2.49%

Plant In Service 6/30/85		\$1,128,262
Proposed Plant Additions		<u>1,005,500</u>
Total Plant		\$2,133,762
Less Contributions:		
End of test period	\$761,716	
Proposed Addition	<u>665,500</u>	
Total Contributions		<u>1,427,216</u>
Depreciable Property		706,546
X Depreciation Rate		2.5%
Depreciation Allowed for Rate-making		<u>\$ 17,664</u>

Purchased Water Expense

South Cumberland reported \$38,386 for test period purchased water expense. This figure includes water loss of approximately 40 percent.

South Cumberland proposed in this filing a purchased water expense of \$34,295. This figure was based on the addition of 80 new customers as a result of the proposed project and a 23 percent water loss reflective of the water loss that South Cumberland incurred in 1983. The Commission has determined that a water loss in excess of 15 percent should not be allowed for rate-making purposes; therefore South Cumberland's proposal is unacceptable.

The Commission has determined South Cumberland's purchased water expense to be \$32,155 based on the maximum 15 percent water loss and the additional customers.

Other Operating Expenses

South Cumberland proposed increases to labor, utilities, insurance, professional fees, miscellaneous expenses and billing. These proposed expenses amount to a total increase to South Cumberland's operating expenses of \$3,889. South Cumberland provided no support for these increases other than estimates

based on the proposed expansion. Mr. Grier testified at the hearing that South Cumberland could not provide further support for these increases. The Commission generally does not allow adjustments that are not known and measurable; however, in this instance the increases proposed have no material effect upon the Commission's final determination in this matter and thus no adjustment has been made at this time. This decision does not imply the Commission's future acceptance of these or similar adjustments not meeting the criteria of being known and measurable.

Supplies Expense

South Cumberland proposed to reduce test period operations and supplies expense by \$5,035. This figure represents the cost of a new pump that South Cumberland initially expensed but later capitalized. The Commission concurs with South Cumberland's decision and the resulting decrease to test period operations and maintenance expense.

Adjustments to South Cumberland's test period operations produced the following results:

	<u>Actual</u>	<u>Company Adjustments</u>	<u>Commission Adjustments</u>	<u>Commission Approved</u>
Operating Revenues	\$95,473			\$ 95,473
Operating Expenses	104,713	(1,146)	(16,687)	86,880
Operating Income	<u>\$(9,240)</u>	<u>\$ 1,146</u>	<u>\$16,687</u>	<u>\$ 8,593</u>

REVENUE REQUIREMENTS

The Commission has determined South Cumberland's average annual debt service for the 5 years subsequent to the test period to be \$38,990. This figure is reflective of the new debt of

\$340,000 at a 7 percent interest rate. The adjusted operating income of \$8,593 plus interest income in the amount of \$3,689 results in total income for rate-making purposes of \$12,291 and will allow South Cumberland a debt-service coverage ("DSC") of .32.

The additional revenues granted in this case will provide South Cumberland with a DSC of .90. The Commission has determined that a 1.0 DSC is required to allow a company to break even. Therefore, the Commission is concerned that a .90 DSC may not be sufficient for South Cumberland to cover its operating expenses and service its debt.

The Commission advises South Cumberland to review its financial position after completion of the expansion program and to take appropriate action.

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 revised in the record be performed and that a certificate of public convenience and necessity be granted.

2. The proposed construction consists of two elevated water storage tanks, two booster pumping stations, approximately 19 miles of 6-inch and 4-inch diameter pipelines, and related appurtenances to serve 80 additional customers. The low bids totaled \$844,112, which will require about \$1,005,500 after

allowances are made for fees, contingencies, other indirect costs and previously completed construction.

3. 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.

4. South Cumberland should furnish duly verified documentation of the total cost 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.

5. South Cumberland'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 drawings and specifications and in conformance with the best practices of the construction trades involved in the project.

6. South Cumberland 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.

7. The financing plan proposed by South Cumberland is for the lawful objects within the corporate purpose of its utility

operations, is necessary and appropriate for and consistent with the proper performance of its service to the public and will not impair its ability to perform that service and should, therefore, be approved.

8. The rates and charges in Appendix A are fair, just and reasonable rates and charges to be charged by South Cumberland in that they should produce gross revenues from South Cumberland's operations of \$118,349.

IT IS THEREFORE ORDERED that:

1. South Cumberland 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. South Cumberland's financing plan consisting of an FmHA grant of \$655,000, and an FmHA loan of \$340,000 and customer connection fees of \$10,500 be and it hereby is approved.

3. If under new FmHA loan conditions South Cumberland is notified and granted the option of accepting a lower interest rate at the date of closing, South Cumberland 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. South Cumberland shall file a statement of the interest rate accepted from FmHA within 30 days of the date of closing.

5. If South Cumberland 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 South Cumberland 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. South Cumberland shall comply with all matters set out in Findings 3 through 6 as if the same were individually so ordered.

8. The rates in Appendix A be and they hereby are approved for service rendered by South Cumberland on and after the date of this Order.

9. Within 30 days from the date of this Order South Cumberland shall file with this Commission its revised tariff sheets setting out the rates approved herein.

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 3rd day of April, 1986.

PUBLIC SERVICE COMMISSION

Richard D. Weman
Chairman

Robert L. [Signature]
Vice Chairman

Spencer D. Williams
Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 9411 DATED APRIL 3, 1986.

The following rates and charges are prescribed for the customers in the area served by South Cumberland 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.

Rates: Monthly

5/8 Inch x 3/4 Inch Meter

First 2,000 gallons	\$10.20 Minimum Bill
Next 3,000 gallons	3.75 per 1,000 gallons
Next 5,000 gallons	2.70 per 1,000 gallons
All over 10,000 gallons	1.70 per 1,000 gallons

1 Inch Meter

First 5,000 gallons	\$25.50 Minimum Bill
Next 5,000 gallons	2.70 per 1,000 gallons
All Over 10,000 gallons	1.70 per 1,000 gallons

1-1/2 Inch Meter

First 12,500 gallons	\$63.75 Minimum Bill
All Over 12,500 gallons	1.70 per 1,000 gallons

2 Inch Meter

First 25,000 gallons	\$127.50 Minimum Bill
All Over 25,000 gallons	1.70 per 1,000 gallons