

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF LYON COUNTY WATER)
DISTRICT, LYON COUNTY, KENTUCKY (1) FOR)
A CERTIFICATE OF PUBLIC CONVENIENCE AND)
NECESSITY AUTHORIZING SAID DISTRICT TO)
CONSTRUCT MAJOR IMPROVEMENTS AND EX-)
TENSIONS TO ITS EXISTING MUNICIPAL WATER)
DISTRIBUTION SYSTEM PURSUANT TO PRO-) CASE NO. 9524
VISIONS OF CHAPTER 74 OF THE KENTUCKY)
REVISED STATUTES; (2) SEEKING APPROVAL)
OF THE ISSUANCE OF CERTAIN SECURITIES;)
(3) FOR AN ADJUSTMENT OF RATES, AND (4))
APPROVAL TO PURCHASE LAKE BARKLEY WATER)
SYSTEM, INC.)

O R D E R

On March 11, 1986, Lyon County Water District ("Lyon") filed its Application and Motion to reopen Case No. 9120, wherein it had sought Commission approval to increase its water service rates, authorization to construct a \$1,194,100 waterworks improvement project, approval of its financing for the proposed project and approval to purchase the assets of the Lake Barkley Water System. The Commission approved the purchase portion of the application on November 11, 1985, subject to approval of financing from the Farmers Home Administration ("FmHA"). In response to said Motion, the Commission, by Order entered March 18, 1986, established the instant case with the record of Case No. 9120 incorporated herein by reference.

The project financing includes \$100,600 from applicants for service in the proposed project area and a partial refund of the purchase price of the Lake Barkley Water System, a \$75,000 grant from the U.S. Army Corps of Engineers, a \$420,500 grant from the FmHA and a \$598,000 loan from the FmHA. The FmHA loan will be secured by waterworks revenue bonds maturing over a 40-year period at an interest rate of 9 1/8 percent per annum.

The proposed project will add 335 customers to Lyon's system. One hundred forty-one are existing customers of the Lake Barkley Water System and 194 are additional applicants for service. Plans and specifications for the construction prepared by Elrod-Dunson, Inc., of Nashville, Tennessee, ("Engineer") 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 April 30, 1986. There were no intervenors present and no protests were entered.

The rates requested by Lyon were the rates proposed in FmHA's letter of conditions. The Commission has determined that these rates, charged to the approximately 620 customers that Lyon will serve upon completion of the proposed construction project, will produce additional revenue of \$37,182 on an annual basis. In this Order, the Commission has approved the entire amount of the requested increase.

TEST PERIOD

Lyon proposed and the Commission has accepted the 12-month period ending December 31, 1984, as the test period in this matter.

REVENUES AND EXPENSES

Lyon reported a net operating income of \$6,536 for the test period and proposed two pro forma adjustments which resulted in an adjusted net operating income of \$44,507. The Commission, upon reviewing Lyon's pro forma revenues and expenses, has made the following adjustments in order to reflect expected operating conditions:

Operating Revenues

Lyon proposed an adjustment to increase operating revenues by \$44,064 to reflect the sales to the additional customers being added to the system. This adjustment was calculated by multiplying the amount of an average residential bill - \$12.24 - by 300 new customers by 12 months. The Commission is of the opinion that a more accurate method of projecting the revenues to be generated from the new customers would be to include projected usage in the billing analysis.

Of the 335 now being added, Lyon is adding one commercial customer, Eddy Creek Recreational Area, which is projected to use 100,000 gallons per month. The remaining 334 being added to Lyon's system are residential customers. At Lyon's current rates, sales to Eddy Creek Recreational Area will produce \$1,758 in annual revenues. At an average of 2,419 gallons per customer per month, Lyon's total gallons sold to new residential customers

should be approximately 9,694,300 gallons. The effect of these additional residential sales is to increase Lyon's annual revenues by \$41,700. This amount, along with the commercial revenues of \$1,758, results in an adjustment to annual operating revenues of \$43,458.

Purchased Water Expense

Lyon proposed an adjustment of \$6,093 to increase purchased water expense to reflect the additional customers being added to its system. However, as with its proposed adjustment to operating revenues Lyon reflected only 300 additional customers while the actual number being added to the system is 335. In addition, although Lyon reported a test year water loss of 14.5 percent, it did not allow any water loss for the additional water purchases needed to serve the new customers.

The Commission, based on Lyon's average residential usage of 2,419 gallons and the estimated monthly usage of 100,000 gallons by the U.S. Army Corps of Engineers at the Eddy Creek Recreational Area, has determined that Lyon's water sales should increase by approximately 10.9 million gallons annually. Allowing for Lyon's 14.5 percent historical water loss, its water purchases should increase by 12.74 million gallons, which, at Lyon's contract rate of \$.70 per 1,000 gallons, results in an adjustment to increase Lyon's test year expense for purchased water by \$8,916.

Depreciation Expense

For the test year Lyon reported depreciation expense of \$15,390; however, it did not propose an adjustment to increase

depreciation expense due to the planned construction project. In view of the proposed construction project the Commission finds the following adjustments to be appropriate for rate-making purposes.

Lyon's test year-end utility plant in service was \$604,980, which, based on Lyon's test year depreciation expense of \$15,390 results in a composite depreciation rate of 2.54 percent. Using this composite rate for the proposed addition of \$1,194,100 in utility plant results in total depreciation expense for accounting purposes of \$45,768. However, 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. The financing for the proposed construction project will increase Lyon's contributions in aid of construction by \$596,100. The result of these additions will be reflected as follows:

Utility Plant in Service	\$1,799,080
Less:	
Contributions in Aid of Construction	939,534
Non-Contributed Utility Plant	<u>\$ 859,546</u>
X Composite Rate	.0254
Depreciation on Non-Contributed Utility Plant	<u><u>\$ 21,832</u></u>

This calculation results in an adjustment to increase depreciation for rate-making purposes by \$6,442 above the test year expense level.

After all adjustments, Lyon's test period operations appear as follows:

	Test Year Actual	Commission Adjustments	Test Year Adjusted
Operating Revenues	<u>\$53,364</u>	<u>\$43,458</u>	<u>\$96,822</u>
Operating Expenses	<u>46,828</u>	<u>15,358</u>	<u>62,186</u>
Operating Income	<u>\$ 6,536</u>	<u>\$28,100</u>	<u>\$34,636</u>

REVENUE REQUIREMENTS

Lyon's annual debt service based on debt outstanding at the end of the test year and debt proposed in this proceeding is \$73,193. The adjusted operating income of \$34,636 plus non-operating income of \$2,421 results in total income for rate-making purposes of \$37,057 and will allow Lyon a debt service coverage ("DSC") of .51X.

The additional revenues granted herein are based on Lyon's requested rates without a surcharge and will provide Lyon with a DSC of 1.01X assuming the adjusted test period operations accurately reflect Lyon's pro forma operations. In a case such as this where Lyon is adding a large number of customers not previously served by an operating utility, accurate estimates or projections of increased operation and maintenance expenses are difficult. Based on the limited information available in this case neither Lyon nor the Commission made such adjustments. Therefore, the Commission is concerned that the additional

revenues of \$37,182 granted herein may not be sufficient for Lyon to meet its operating expenses and service its debt.

The Commission advises Lyon to review its financial position after one year of operation of its expanded system and take appropriate action as it deems necessary. The Commission will monitor Lyon's financial condition through review of Lyon's annual reports for the purpose of determining what, if any, future rate adjustments might be necessary.

RATE DESIGN

Lyon proposed a declining block rate structure and a surcharge applicable to new customers. The Commission will approve a declining block rate structure for Lyon. However, the Commission will not approve Lyon's proposed customer surcharge, as surcharges of this type are contrary to long-standing Commission policy.

The surcharge proposed by Lyon is apparently intended to recover the cost of Lyon's expansion project. However, the record in this case does not specifically link the proposed surcharge with such capital recovery. Neither does the record indicate any compelling reason to approve the surcharge.

On occasion, the Commission does approve surcharges that are directly linked to the recovery of specific capital or operating expenses and which are of limited short-term duration. The Commission does not ordinarily allow surcharges involving expansion projects. Expansion projects benefit rate payers in general and are, at least in this instance, financed through long-term loans.

Lyon's FmHA letter of conditions contains two rate schedules acceptable to FmHA. One includes a customer surcharge. The other does not. Accordingly, consistent with Commission policy concerning customer surcharges, the Commission will approve the rate schedule contained in Lyon's FmHA letter of conditions that does not include a customer surcharge.

In addition, Lyon proposed to increase its meter connection charges effective upon completion of the construction approved in this case. The Commission will not approve increased meter connection charges at this time. The need for increased meter connection charges has not been substantiated in the record of this case and the Commission has not considered additional revenues from increased meter connection charges in determining Lyon's revenue requirement. In the alternative, the Commission advises Lyon that in the future it may apply for increased meter connection charges outside a general rate case proceeding under the provisions of 807 KAR 5:011, Section 10.

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 Lyon water system includes 194 service connections, about 21 miles of 8-, 6-, and 4-inch

water main, a 200,000-gallon water storage tank, a booster pumping station and miscellaneous appurtenances. The low bids received for the proposed construction totaled \$734,799 which will require about \$1,194,100 in project funding after allowances are made for fees, contingencies, other indirect costs, the purchase of the Lake Barkley Water System and additional construction being considered as a result of receiving bids under the final estimate.

3. Lyon 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. Lyon 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. Lyon'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. Lyon 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 Lyon 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.

10. The financing secured by Lyon for this project will be needed to pay for the work herein approved. Lyon's financing plan should, therefore, be approved.

11. The rates and charges in Appendix A are fair, just and reasonable and should produce gross operating revenues of \$134,004 for Lyon.

IT IS THEREFORE ORDERED that:

1. Lyon be and it hereby is granted a certificate of public convenience and necessity to proceed with the proposed con-

struction project as set forth in the drawings and specifications of record herein.

2. Lyon's plan of financing consisting of a loan from the FmHA in the amount of \$598,000 with an interest rate of 9 1/8 percent and a 40-year term, a grant from the FmHA in the amount of \$420,500, a grant from the U.S. Army Corps of Engineers in the amount of \$75,000 and \$100,600 from applicants for service and a partial refund of the purchase price of the Lake Barkley Water System be and it hereby is approved.

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

5. If Lyon 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 Lyon 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 cost associated with the loan over its life.

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

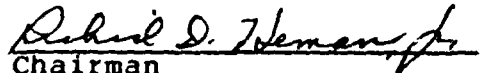
8. The rates in Appendix A be and they hereby are approved for service rendered by Lyon on and after the date of this Order.

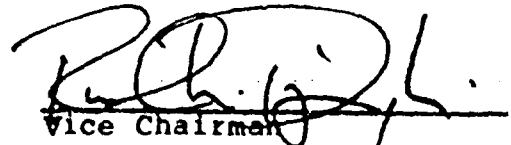
9. Within 30 days from the date of this Order Lyon shall file with the Commission its revised tariff sheets setting out the rates approved herein.

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 11th day of July, 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. 9524 DATED JULY 11, 1986.

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

5/8" Meter Service

First 2,000 gallons	\$11.90 (Minimum Bill)
Next 3,000 gallons	4.90 per 1,000 gallons
Next 5,000 gallons	3.50 per 1,000 gallons
Next 10,000 gallons	2.10 per 1,000 gallons
Over 20,000 gallons	1.75 per 1,000 gallons

3/4" Meter Service

First 4,000 gallons	\$21.70 (Minimum Bill)
Next 1,000 gallons	4.90 per 1,000 gallons
Next 5,000 gallons	3.50 per 1,000 gallons
Next 10,000 gallons	2.10 per 1,000 gallons
Over 20,000 gallons	1.75 per 1,000 gallons

1" Meter Service

First 15,000 gallons	\$54.60 (Minimum Bill)
Next 5,000 gallons	2.10 per 1,000 gallons
Over 20,000 gallons	1.75 per 1,000 gallons

1 1/2" Meter Service

First 25,000 gallons	\$73.85 (Minimum Bill)
over 25,000 gallons	1.75 per 1,000 gallons

2" Meter Service

First 45,000 gallons	\$108.85 (Minimum Bill)
Over 45,000 gallons	1.75 per 1,000 gallons