COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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| THE APPLICATION OF WEST MCCRACKEN COUNTY WATER DISTRICT FOR (1) GENERAL RATE INCREASE, (2) REVISION OF TARIFFS, (3) APPROVAL OF SURCHARGE, AND (4) REQUEST FOR APPROVAL OF VARIANCE ON FINANCIAL DATA | ) CASE NO. 94-450 |

O R D E R

On December 22, 1994, West McCracken County Water District ("West McCracken") applied for a general rate increase, a revision of its tariffs, approval of a surcharge, and approval of a variance on financial data. The rates proposed by West McCracken would have generated an annual increase of approximately $106,227. On January 12 and 13, 1995, Commission Staff ("Staff") performed a limited financial review of West McCracken's operations and prepared a cost-of-service study for the test year, calendar year 1993. Based upon this review, Staff issued a Report on April 17, 1995, recommending that West McCracken be allowed to increase its annual operating revenues from water sales by $96,303 [Staff Report at 2]. In addition, Staff recommended a rate design based upon the cost-of-service study.

Subsequently, at an informal conference held May 10, 1995, and in its Response to Staff Report ["Response"], West McCracken objected to several Staff recommendations, arguing, inter alia, that various regulations pertaining to water line extensions should not apply to it [for discussion see July 27 Order, at 6-9]; that the recommended revenue increase was insufficient to retire its bond obligations by 2007 [Response at 2; Informal Conference Memorandum at 2]; and that the rates proposed by staff, which were based upon the actual cost of service, would constitute a "tremendous increase" in most customers' bills and were "unfair" [Response at 3]. The Commission, in its July 27, 1995 Order, rejected West McCracken's demand that it be exempt from extension regulations, but approved the additional revenue increase requested by West McCracken, ordering a revenue increase of $104,540. Although the cost-of-service based rates proposed in the Staff Report are fair, the Commission did not fully implement them due to concerns expressed by West McCracken. Accordingly, a modified rate structure designed to lessen the impact on smaller users was ordered.

After entry of the final Order, West McCracken delivered itself of various startling, and flatly contradictory, statements. On August 15, 1995, West McCracken filed an Application for Rehearing, claiming belatedly to have discovered "errors" in the Staff Report, issued some four months earlier, that result in "over $57,000.00 in excess revenue." Meanwhile, in an inexplicable letter to its customers, dated August 7, 1995 ("Letter to Customers"), filed with the Commission on August 18, 1995, West McCracken stated, "the rates ordered by the PSC will generate income for this District which far exceeds the amount required for efficient operation." Then, in an addendum to its Application for Rehearing ["Addendum"], filed August 18, 1995, West McCracken declared, "There is no disagreement on the amount of the increase." The latter statement directly contradicts the first two. It remains unclear why West McCracken sent a letter to its customers which so contradicted the information it had provided to the Commission. To ascribe these actions to error is almost as alarming as ascribing them to more Machiavellian motives.

## PROCESS OF REVIEW

Upon receipt of the Application for Rehearing, the Addendum, and the Letter to Customers, the Commission carefully reviewed the Staff Report to ascertain whether there was indeed an "error." There was none. The Commission then analyzed the Addendum, which purports to offer a mathematical explanation for the alleged $57,000 error. The analysis showed no error as alleged, but did reveal various errors, both conceptual and mathematical,[1] on the part of West McCracken. The errors range from West McCracken's statement that it had proposed a $5.00 charge for 1" meters [Addendum at 2] when it had actually proposed a $15.00 charge [Notice of Proposed Rate Increase, Exhibit 5 to Application, at 2], to West McCracken's unexplained alteration of the number of gallons sold in the test year: in the Addendum, at 2, it claims 86,000,000 gallons sold, but Table T, Exhibit 3 to Application shows 83,440,082 gallons sold.

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1 For example, in the Addendum, at 2, West McCracken purports to calculate the revenue from water sales when 17,000,000 gallons are sold at a rate of $3.24 per thousand. The total reached by West McCracken is $55,880. The correct answer to the calculation is $55,080.

In its Addendum, West McCracken maintains that the alleged $57,711 in excess revenue results from an error in the calculation of the customer charge for 5/8" meter users. To reach this amount, West McCracken decreases its revenue requirements by $20,587 and increases its revenues available to offset revenue requirements by $37,124.

West McCracken suddenly claimed, without any foundation, $37,124 more in revenues than had been calculated by Staff, despite the fact that the Staff Report containing those calculations had been made available to West McCracken over three months prior to the issuance of the July 27 Order, which set rates based on those revenue figures. A detailed comparison, with explanations, of West McCracken's revenues, as calculated by West McCracken in its Addendum to Application for Rehearing and as calculated in the Commission's final Order, is as follows:

| | Revenue per Final Order as Reflected in Addendum | Actual Revenue per Final Order | Increase (Decrease) |
|---|---|---|---|
| Revenue from Water Sales | $424,495 | $413,639 | $10,856 |
| Penalties | 6,000 | 5,953 | 47 |
| Service Charges | 300 | 300 | -0- |
| Other Operating Revenues | -0- | 7,654 | (7,654) |
| Interest Income | 2,500 | 625 | 1,875 |
| Tap-On Fees | 32,000 | -0- | 32,000 |
| Total | $465,295 | $428,171 | $37,124 |

Water Sales: West McCracken's increase in revenue from water sales results from its sudden and unexplained use of a different number of gallons sold. Revenues from water sales, as calculated in Staff's cost-of-service study, the Staff Report, and the final Order, were based on total gallons sold of 83,440,082 as shown on Table T, Exhibit 3, of Application. In its filing for Rehearing, West McCracken based its calculations on 86,000,000 total gallons sold. Use of this new, unsubstantiated figure resulted in the $10,856 increase in revenue from water sales.

Penalties: The $47 difference is most likely due to rounding.

Service Charges: No difference.

Other Operating Revenues: No explanation was provided for the exclusion of these revenues. Such revenues, if properly classified, are always included in revenue totals.

Interest Income: No explanation was provided to justify this increase.

Tap-On Fees: These fees constitute contributions in aid of construction and are used to cover construction costs. They are not available to offset revenue requirements.

It is clear from this comparison that West McCracken erroneously calculated its revenues in its Application for Rehearing, particularly by including tap-on fees as revenue.

Furthermore, as mentioned above, West McCracken in its Addendum proposes that the revenue requirements should not include expenses of $20,587 charged to the maintenance-services account, claiming that these costs are expended solely for new customers and recovered entirely by tap-on fees. The argument that all new meter costs are for new customers is, at the very least, counter-intuitive, given the need to replace older equipment. Moreover, this issue was investigated during field review and the findings resulting from this investigation are recorded at page 8 of the Staff Report.

West McCracken also argues that expenses for maintenance-hydrants and salaries-hydrants, respectively, should not be included in the customer charge. However, these expenses are not included in any other revenue classification in the revenues proposed in the Addendum.

## RATE DESIGN

It is clear that, despite West McCracken's misguided efforts to establish an error in revenue calculations, its real objective is to lower the price of water for the majority of its customers at the expense of a few. In its Letter to Customers, West McCracken declares that it does "not understand" the rate ordered for 5/8" meter customers. It also claims the 5/8" rate is "inequitable." Consequently, the Commission shall explain its reasoning, and the principles behind that reasoning, for the benefit of both West McCracken and the customers it has misled.

The purpose of a cost-of-service study is to allocate expenses among the different customer classifications. Revenues should be derived from each class of customer in a manner that is consistent with the cost of providing service to that class of customer. It is the statutory obligation of the Commission to ensure that customers are treated fairly and that pricing is not unduly discriminatory. A cost-of-service study eliminates a great number of assumptions that are made in the recovery of costs among the customer classifications and places limits on the remaining assumptions that must be made.

The American Water Works Association explains how costs can be assigned to customer classes based on water system functions. See American Water Works Association, Water Rates: AWWA Manual M1 (3rd Ed. 1983). The cost-of-service study on which West McCracken's rates are based was done in accordance with a method set out in this manual. The manual also points out, at 39, that "[d]eparture from rates based on cost of service is generally a decision made for political, legal, or other reasons. Consideration of rates deviating from cost of service, therefore, is made by politicians, not the rate designer."

Despite West McCracken's claims to the contrary, West McCracken's former rates for some of its 5/8" meter customers have been subsidized by the rates paid by larger users, based upon the actual cost to provide service. West McCracken is currently attempting to increase that subsidy substantially in its proposal for a total revenue increase of approximately 25 percent and a simultaneous reduction in rates for some low volume users. West McCracken did not prepare its own cost-of-service study. It has, however, seen the cost-of-service study prepared by Staff and should be fully aware that smaller users are already subsidized by large ones. West McCracken should also be aware that, in the interest of avoiding "rate shock" for smaller customers, the rates in the Commission's final Order continue that subsidy, albeit in modified form. The Commission regrets what appears to be West

McCracken's continued efforts to prod its customers to anger against fairly calculated rates.

STANDARD FOR REHEARING

To obtain rehearing, a party must offer "evidence that could not with reasonable diligence have been offered on the former hearing." KRS 278.400. West McCracken has made no such offer. There was no "error" in the Staff Report. Second, even if there were such an "error," it could with "reasonable diligence" have been brought before the Commission long before the final Order was issued on July 27. The Staff Report which contains the purported error was sent to West McCracken on April 17.

Although no formal, oral hearing has been held, West McCracken was informed by Order dated April 17, 1995 that it was entitled to request a hearing. It did not do so. However, it met informally with Staff and has filed numerous documents in support of its arguments, all of which have been fully reviewed and considered by the Commission. A formal, oral hearing is not required under these circumstances, since West McCracken has presented its case by documentary evidence. 2 Am.Jur.2d Administrative Law, Section 303, at 317. See also Kentucky Bar Ass'n v. Ricketts, Ky., 599 S.W.2d 454, 456 (1980) (a "fair hearing" was afforded attorney who was suspended from practice of law, despite lack of oral, evidentiary hearing). Furthermore, there is no genuine issue of material fact presented. See Cumberland Reclamation Co. v. Secretary, Dept. of the Interior, 925 F.2d 164 (6th Cir. 1991) (formal hearing unnecessary when substantial evidence supported the agency's finding that no issue of material fact existed). There is not even an immaterial issue that could not have been raised prior to the final Order.

The Commission, having reviewed the evidence of record and being otherwise sufficiently advised, HEREBY ORDERS that:

1. West McCracken's Application for Rehearing is hereby denied.

2. West McCracken shall file, within 30 days of the date of this Order, its revised tariffs setting out the rates and surcharge approved in the Commission's Order dated July 27, 1995.

Done at Frankfort, Kentucky, this 1st day of September, 1995.

PUBLIC SERVICE COMMISSION

Chairman

Robert M Davis

Vice Chairman

Linda K Breathitt

Commissioner

ATTEST:

Don Mills

Executive Director