

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF NORTH NELSON WATER )  
DISTRICT (1) FOR A CERTIFICATE OF PUBLIC )  
CONVENIENCE AND NECESSITY AUTHORIZING )  
CONSTRUCTION OF MAJOR ADDITIONS AND )  
IMPROVEMENTS TO ITS WATER DISTRIBUTION )  
SYSTEM; (2) SEEKING APPROVAL OF REVISED ) CASE NO. 97-255  
WATER SERVICE RATES AND CHARGES; AND )  
(3) SEEKING APPROVAL OF THE ISSUANCE OF )  
CERTAIN SECURITIES, PURSUANT TO THE )  
PROVISIONS OF KRS 278.020, KRS 278.300, )  
AND 807 KAR 5:001 )


O R D E R

On June 20, 1997, North Nelson Water District ("North Nelson") filed its application for Commission approval of proposed water rates. Commission Staff, having performed a limited financial review of North Nelson's operations, has prepared the attached Staff Report containing Staff's findings and recommendations regarding the proposed rates. All parties should review the report carefully and provide any written comments or requests for a hearing or informal conference no later than 10 days from the date of this Order.

IT IS THEREFORE ORDERED that all parties shall have no more than 10 days from the date of this Order, or 90 days after the date the application was filed, whichever is later, to provide written comments regarding the attached Staff Report or requests for a hearing or informal conference. If no request for a hearing or informal conference is received, this case will be submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this 3rd day of October, 1997.

ATTEST:



Executive Director

PUBLIC SERVICE COMMISSION

  
For the Commission

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF NORTH NELSON )  
WATER DISTRICT (1) FOR A CERTIFICATE )  
OF PUBLIC CONVENIENCE AND NECESSITY )  
AUTHORIZING CONSTRUCTION OF MAJOR )  
ADDITIONS AND IMPROVEMENTS TO ITS )  
WATER DISTRIBUTION SYSTEM; (2) SEEKING )  
APPROVAL OF REVISED WATER SERVICE RATES )  
AND CHARGES; AND (3) SEEKING APPROVAL )  
OF THE ISSUANCE OF CERTAIN SECURITIES, )  
PURSUANT TO THE PROVISIONS OF KRS 278.020, )  
KRS 278.300, AND 807 KAR 5:001 )

CASE NO.  
97-255

STAFF REPORT

Prepared By: Carl Salyer Combs  
Public Utility Financial  
Analyst, Senior  
Water and Sewer Revenue  
Requirements Branch  
Financial Analysis Division

Prepared By: Carryn Lee, Manger  
Communications, Water and  
Sewer Rate Design Branch  
Rates and Research Division

STAFF REPORT

ON

CASE NO. 97-255

A. Preface

On June 20, 1997, North Nelson Water District ("North Nelson") filed an application with the Commission seeking to increase its water rates. The proposed rates would generate approximately \$198,201 annually in additional revenues.

In order to evaluate the requested increase, the Commission Staff ("Staff") chose to perform a limited financial review of North Nelson's operations for the test period, calendar year 1996. Carl Salyer Combs conducted the review on July 21, 1997, at North Nelson's office in Cox's Creek, Kentucky. Mr. Combs is responsible for this Staff Report except for the sections on operating revenues and rate design which were prepared by Carryn Lee of the Commission's Division of Rates and Research.

During the course of the review, North Nelson was informed that all proposed adjustments to test-year expenses must be supported by some form of documentation, such as an invoice, or that all such adjustments must be known and measurable. Based upon the findings of this report, Staff recommends that North Nelson be authorized to increase its annual operating revenues from water sales by \$198,201.

Scope

The scope of the review was limited to obtaining information to determine whether reported test-period operating revenues and expenses were representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

B. Analysis of Operating Revenues and Expenses

Operating Revenues

North Nelson reported test year operating revenue from water sales in the amount of \$567,267. A billing analysis for the test year was prepared by North Nelson which produced revenue from water sales in the amount of \$567,792. The difference of \$525 between the billing analysis and annual report is well within an acceptable level. For the purposes of this report the revenue produced by the billing analysis will be used. North Nelson proposed to adjust its revenue to include 266 customers that were not on the system during the test year. Based on test year rates this increase in customers will generate an additional \$58,992 in revenue. North Nelson also reported \$14,159 in other revenue which includes forfeited discounts and miscellaneous service revenue. Staff has determined that total normalized test year revenue is \$640,943 with \$626,784 of this amount being revenue from water sales.

Operating Expenses

North Nelson incurred test-period operating expenses of \$539,152 and proposed expense adjustments to increase the test-period amount by \$123,095. Staff's review of North Nelson's expenses included examining supporting documents such as invoices. Staff's recommendations are discussed in the following sections:

Salaries Expense - Employees

North Nelson reported test-year salaries expense for employees of \$94,040. Although no increase was proposed in North Nelson's application, Staff learned at the field review that four employees received pay increases of 3.5 percent, effective April 1, 1997.

Staff is of the opinion that the proposed increase is reasonable and has, therefore, included test-year salaries for employees of \$97,145 (\$94,040 + \$3,105) for rate-making purposes.

Purchased Water Expense

North Nelson proposed to increase reported test-year purchased water expense of \$217,959 by \$64,412 based upon additional customers. Staff's review of test-year invoices yielded a test-year total of \$216,209. Staff is of the opinion that North Nelson's proposed adjustment is reasonable. Therefore, Staff has included annual purchased water expense of \$280,621 (\$216,209 + \$64,412) for rate-making purposes.

On January 15, 1996, North Nelson entered into an agreement with Kentucky Turnpike Water District ("Kentucky Turnpike") to purchase up to 8 million gallons of water per month. Under the terms of the contract North Nelson will be obligated to purchase a minimum of 4,000,000 gallons per month at a minimum monthly charge of \$7,880 with all additional water being billed at a rate of \$1.75 per 1,000 gallons. Since Kentucky Turnpike has not filed the agreement with the Commission as required by 807 KAR 5:011, Section 13, Staff recommends that North Nelson be required to keep all funds collected to pay Kentucky Turnpike in an interest bearing escrow account until such time as the contract is approved by the Commission.

Electric Expense

North Nelson proposed to increase reported test-year electric expense of \$12,932 by \$1,356 based upon additional customers. Staff's review of test-year invoices yielded a test-year total of \$13,501. Subsequent to the field review, North Nelson informed Staff that one component of its proposed electric expense adjustment was in error and that the

correct amount of adjustment should be \$407. Staff's Engineering Division is of the opinion that the proposed adjustment is reasonable. Therefore, Staff recommends inclusion of annual electric expense of \$13,908 (\$13,501 + \$407) for rate-making purposes.

#### Customer Accounts Expense

North Nelson's annual report for the test year does not include an account labeled "customer accounts." However, amounts from several expense accounts have been allocated to "customer accounts expense" as shown on page 30 of North Nelson's 1996 annual report. In its application, North Nelson proposed customer accounts expense of \$6,916, based upon the test-year amount per customer multiplied by the number of additional customers (\$26 X 266). Staff is of the opinion that the proposed adjustment is reasonable and, therefore, recommends inclusion of annual additional customer accounts expense of \$6,916 for rate-making purposes.

#### Transmission and Distribution Expense

North Nelson's test-year annual report includes no account labeled "transmission and distribution expense." Amounts from several expense accounts have been allocated to two categories shown on page 30 of the 1996 annual report, categories identified as "transmission and distribution expenses." North Nelson, in its application, proposed a transmission and distribution cost of \$19,800. The proposed adjustment was not supported by invoices or other form of documentation. Therefore, no additional transmission and distribution expense has been included for rate-making purposes.

#### Depreciation Expense

North Nelson proposed to increase reported test-year depreciation expense of \$85,828 by \$30,611, based upon only the cost of a storage tank, materials, and installation

of materials spread over 50 years. Staff is of the opinion that other costs, specifically engineering, legal, administrative, capitalized interest, bond issuance, debt service reserve, and contingency expenses, should be included in the calculation of annual depreciation expense and that 40 years is a more appropriate period over which to depreciate said items. Thus, Staff recommends an adjustment to depreciation expense of \$66,481 ( $\$2,659,250/40$  years) and has included annual depreciation expense of \$152,309 for rate making purposes.

#### Taxes Other Than Income Taxes Expense

North Nelson reported test-year taxes other than income taxes expense of \$7,620. Due to the increase in salaries for employees recommended by Staff in a previous section, a corresponding adjustment for FICA taxes should be made. The salary increase of \$3,105 multiplied by the current FICA rate of 7.65 percent results in additional taxes of \$238. Staff, therefore, recommends inclusion of annual taxes other than income taxes expense of \$7,858 for rate-making purposes.

#### Interest Income

During the test period, North Nelson earned interest income of \$25,848. In Exhibit 8 of its application, North Nelson estimated that it would earn an additional \$9,640 on funds to be held on deposit.<sup>1</sup> Staff is of the opinion that the estimated increase in interest income is reasonable. Therefore, \$35,488 of interest income has been included in determining North Nelson's revenue requirement.

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<sup>1</sup>Application Exhibit 8, Footnote #1.

Operations Summary

Based on the recommendations of Staff contained in this report, North Nelson's operating statement would appear as shown in Attachment 1.

C. Revenue Requirements Determination

North Nelson's average annual debt service for the next three years, including the proposed debt, amounts to \$261,908. North Nelson's adjusted operations reflect a negative \$1,657 in income available for debt service. The rates proposed by North Nelson will produce a debt service coverage ("DSC") of 1.02X. In cases involving water utilities, the Commission's normal practice is to allow a 1.2 DSC which provides a 20 percent margin above annual principal and interest requirements. Using that standard, North Nelson could justify an increase in annual revenues of \$245,635 calculated as follows:

1.2X DSC	\$314,290
Adjusted Operating Expense	<u>679,530</u>
Total Revenue Requirement	\$993,820
LESS:	
Adjusted Test-Year Revenues	640,943
interest Income	35,488
Annual Surcharge Rev.	58,116
Other Inc./Deductions	<u>13,638</u>
Increase Required	<u>\$245,635</u>

However, since North Nelson's proposed rates will produce a positive cash flow of \$86,945, Staff recommends the Commission approve North Nelson's proposed rates. North Nelson may wish to amend its application to reflect the additional revenues that could be justified. Such an amendment should be filed with any comments on the Staff Report. Should North Nelson amend its application, Staff recommends that North Nelson be required to notify its customers of the amended rate proposal.

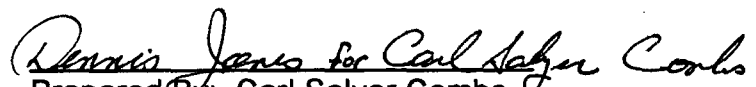


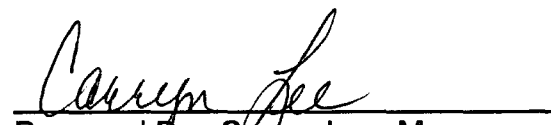
D. Rate Design

North Nelson is assessing a \$2,500 customer contribution from the customers connecting to the new extension. Of those new customers, 167 have elected to pay a \$29 per month surcharge for a period of 10 years. The proposed surcharge would, therefore, produce \$58,116 (167 X \$29 X 12 months) annually in additional revenue.

North Nelson proposed to increase each rate step by approximately 32 percent. After reviewing the billing analysis and customer usage Staff finds that the proposed rates should be accepted. The rates set out in Appendix A and as proposed by North Nelson will produce revenue from water sales in the amount of \$824,985. Staff determined that North Nelson actually needed annual revenue from water sales of \$872,419. The rates in Appendix B will produce this amount. If North Nelson desires to accept the rates set out in Appendix B it will be required to notify its customers of the proposed increase.

E. Signatures

  
Prepared By: Carl Salyer Combs  
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Analyst, Senior  
Water and Sewer Revenue  
Requirements Branch  
Financial Analysis Division

  
Prepared By: Carryn Lee, Manager  
Communications, Water and  
Sewer Rate Design Branch  
Rates and Research Division

ATTACHMENT 1  
TO STAFF REPORT IN CASE NO. 97-255

	<u>Test Period</u> <u>Application</u>	<u>Recommended</u> <u>Adjustments</u>	<u>Test Year</u> <u>Adjusted</u>
Revenues:			
Water Sales	\$ 567,267	\$ 59,517	\$ 626,784
Other Revs.	<u>14,159</u>	<u>-0-</u>	<u>14,159</u>
Total Rev.	\$ 581,426	\$ 59,517	\$ 640,943
Expenses:			
Sal. - Employees	94,040	3,105	97,145
Sal. - Officers	7,200	-0-	7,200
Benefits	22,302	-0-	22,302
Purchased Water	217,959	62,662	280,621
Electricity	12,932	976	13,908
Chemicals	248	-0-	248
Mat. & Supplies	34,438	-0-	34,438
Contract. Serv. - Accounting	5,300	-0-	5,300
Contract. Serv. - Other	27,745	-0-	27,745
Transportation	5,436	-0-	5,436
Insurance - Auto	2,545	-0-	2,545
Ins. - Gen. Liab.	2,262	-0-	2,262
Ins. - Work. Comp.	2,671	-0-	2,671
Ins. - Other	2,349	-0-	2,349
Customer Accounts	-0-	6,916	6,916
Bad Debt	837	-0-	837
Miscellaneous	7,440	-0-	7,440
Depreciation	85,828	66,481	152,309
Taxes Other Than Income Taxes	<u>7,620</u>	238	7,858
Total Expense	\$ <u>539,152</u>	\$ <u>140,378</u>	\$ <u>679,530</u>
Net Operating Income	\$ 42,274	\$( 80,861)	\$( 38,587)
Other Inc./Ded.:			
Interest/Div.	\$ 25,848	\$ 9,640	\$ 35,488
Nonutil. Inc.	1,442	-0-	1,442
Income Available for Debt Service	\$ <u>69,564</u>	\$ <u>(71,221)</u>	\$ <u>(1,657)</u>

APPENDIX A

APPENDIX TO A STAFF REPORT IN CASE NO. 97-255, NORTH NELSON WATER DISTRICT.

First 2,000 Gallons	\$12.89 Minimum Bill
Next 3,000 Gallons	3.45 per 1,000 gallons
Next 5,000 Gallons	2.96 per 1,000 gallons
Over 10,000 Gallons	2.63 per 1,000 gallons
Truck Loading Station	6.50 per 1,000 gallons

APPENDIX B

APPENDIX TO A STAFF REPORT IN CASE NO. 97-255, NORTH NELSON WATER DISTRICT.

First 2,000 Gallons	\$13.65 Minimum Bill
Next 3,000 Gallons	3.65 per 1,000 gallons
Next 5,000 Gallons	3.13 per 1,000 gallons
Over 10,000 Gallons	2.78 per 1,000 gallons
Truck Loading Station	6.50 per 1,000 gallons