COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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| PROPOSED ADJUSTMENT OF THE WHOLESALE WATER SERVICE RATES OF THE CITY OF OWENTON, KENTUCKY | ) CASE NO. 98-283 |

O R D E R

Tri-Village Water District ( Tri-Village ) moves for rehearing on the Order of February 22, 1999, in which the Commission authorized the city of Owenton, Kentucky ( Owenton ) to increase its wholesale water service rate to $2.11 per 1,000 gallons and to assess a temporary surcharge of $.04 per 1,000 gallons to recover rate case expenses. Having considered the motion, we grant the application on the issue of rate case expense, but deny on all other issues.

In its motion, Tri-Village first alleges that the Commission erroneously allocated to Tri-Village costs associated with Owenton s fire protection system. This system, Tri-Village alleges, benefits only Owenton s retail customers. None of its costs, therefore, should be allocated to Owenton s wholesale rate. Tri-Village asserts that 28 percent of operation and distribution expenses previously allocated to the wholesale rate should be removed to reflect fire protection costs.

The Commission finds that Tri-Village improperly raises the issue of fire protection costs in its motion. It did not raise the issue during discovery or at hearing. None of the evidence that Tri-Village now offers is evidence that could not with reasonable diligence have been offered on the former hearing. KRS 278.400. Having failed to present the issue earlier, Tri-Village may not, therefore, raise the issue now.

Even if Tri-Village had timely raised the issue of fire protection, its evidence fails to support the claim of improper cost allocation. Its evidence consists of an excerpt from the American Water Works Association s Manual M1, Water Rates. This excerpt generally discusses cost allocation methodologies for fire protection service and contains an estimate of the amount of the fire-service cost as a percentage of total revenue for small water utilities in Maine. Tri-Village has not demonstrated how this estimate is relevant to the case at bar; nor has it presented any evidence on the utilities upon which the estimate is based. Without adequate information about the studies upon which the estimate is based, the Commission has no basis to revisit our earlier decision.

We further find no evidence in the record on the issue of fire protection service in general. There is no evidence on Owenton s fire protection services or capabilities. The record is also devoid of any evidence to suggest that operating and maintenance expenses allocated to Tri-Village include amounts that could be allocated to fire protection service.[1]

Tri-Village next argues that the Commission incorrectly calculated a cost allocation factor used to establish Owenton s wholesale rate. It contends that the factor labeled "Tri-Village Inch Mile Ratio" is incorrect because the factor of .6120[2] applies all

[1] The record shows that Owenton operates several fire hydrants. The Commission in its Order of February 22, 1999 allocated all expenses associated with these hydrants to Owenton.

[2] 128.06 jointly shared inch miles/209.24 total miles = .6120.

shared lines to Tri-Village. Tri-Village contends that this factor should be multiplied by the ratio of Tri-Village water sales to total sales which would result in a factor of .3522.[3]

Tri-Village s argument is based upon an erroneous assumption about the Commission s cost allocation factors. Cost allocations were not, as Tri-Village suggests, based upon total system expense, but upon the allocation factors set forth in Owenton's cost-of-service study.[4] In the Order of February 22, 1999, the Commission identified Owenton s adjusted test year expenses and the portion allocated to Tri-Village.[5] We did not expressly identify any allocation factors, but stated that Owenton s cost-of-service study, with certain noted exceptions, should be accepted as the basis for establishing the wholesale rate.[6] To avoid further confusion, the complete breakdown of expenses is set forth in Appendix A to this Order.

The Commission finds no merit in Tri-Village s argument that a factor of .3522 should be used to allocate water production costs. In the Order of February 22, 1999, the Commission used the inch mile ratio to determine the water production multiplier for Tri-Village. This method allocates line loss and system plant use based on the amount of jointly used lines and is based on the premise that leak potential is directly proportional to pipe length and diameter. Owenton s cost-of-service study shows that Owenton must produce 1.3156 gallons of water to sell one gallon to its retail customers

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[3] .6120 x (103,772,000 sales to Tri-Village/180,351,100 total sales) = .3522.

[4] See Owenton s Notice of Filing of January 4, 1999, City of Owenton Allocation of Water Treatment and Distribution Expenses.

[5] See Order of February 22, 1999, Appendix B, Sheet 3.

[6] Order of February 22, 1999 at 5.

and that it must produce 1.2228 gallons to sell one gallon to Tri-Village. The Commission then multiplied this water production ratio by the ratio of water sold to Tri-Village to total sales to obtain the water production factor of .5348.[7] This allocation method is generally accepted within the regulatory community. Tri-Village has failed to demonstrate that this methodology is inappropriate to the case at bar. Accordingly, the Commission denies Tri-Village s Motion for Rehearing on this issue.

Tri-Village next argues that the Commission erred in allocating both depreciation expense and debt service costs to Tri-Village. Such allocation, it argues, is tantamount to double dipping. [8] At a minimum, it argues, the Commission should require Owenton to deposit the funds designated as depreciation funds into a restricted account to be used only when authorized by Tri-Village to pay for its portion of future changes to shared facilities. To do otherwise, Tri-Village argues, will require the water district to pay for future rate increases for future facilities.

The Commission finds that rehearing on this issue should be denied on two grounds. Despite Tri-Village s characterization of the Commission s action, Kentucky law clearly requires the allocation of both debt service and depreciation expense to Tri-Village. The Commission is required by statute to treat depreciation as an operating expense to provide an adequate fund for renewals, replacement and reserves. Public Service Commission v. Dewitt Water District, Ky., 720 S.W.2d 725, 731 (1986). Debt

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[7] (103,772,000 sales to Tri-Village/180,351,100 total sales) x (1.2228/1.3156) = .5348.

[8] Motion for Rehearing at 2.

service, moreover, represents the legitimate cost of capital used to provide water service to Tri-Village and its recovery is also required.

The practical effect of Tri-Village s proposal, moreover, is to create an ownership interest in Owenton s facilities. Long established legal precedent holds that such a result is impermissible. Customers pay for service, not for the property used to render it. Their payments are not contributions to depreciation or other operating expenses or to capital of the company. By paying bills for service they do not acquire any interest, legal or equitable, in the property used for their convenience or in the funds of the company. Board of Public Utility Commissioners v. New York Telephone Co., 271 U.S. 23, 32 (1926).

Tri-Village next takes exception to the Commission s allocation of a portion of Owenton s system line loss to the water district. It argues that, as Tri-Village has no control over Owenton s operation, restrictions should be placed upon the amount of line loss allocated. Without such restrictions, it argues, allocation of a portion of Owenton s line loss to Tri-Village reduces Owenton s incentive to take corrective measures. Accordingly, Tri-Village requests that the Commission limit Owenton s allowable line loss for rate-making purposes to 10 percent of total production.

The Commission notes that Tri-Village s requested relief is contrary to existing administrative regulations. Administrative Regulation 807 KAR 5:066, Section 6(3), currently provides:

> [F]or rate making purposes a utility's unaccounted-for water loss shall not exceed fifteen (15) percent of total water produced and purchased, excluding water used by a utility in its own operations. Upon application by a utility in a rate case filing or by separate filing, or upon motion by the commission, an alternative level of reasonable unaccounted-

> for water loss may be established by the commission. A utility proposing an alternative level shall have the burden of demonstrating that the alternative level is more reasonable than the level prescribed in this section.[9]

Tri-Village s requested relief requires the Commission to treat municipal utilities, such as Owenton, more severely than it currently treats public utilities such as Tri-Village. Tri-Village offers no reason for such treatment. Accordingly, we deny the request for rehearing on this issue.

Finally, Tri-Village requests rehearing on the issue of rate case expenses. It contends that it did not have the opportunity to review and cross-examine Owenton s final expenses at hearing. Noting that Commission Staff requested Owenton s expenses at the hearing and that Tri-Village did not object to the request, Owenton contends that Tri-Village has waived its opportunity to examine these expenses.

The Commission finds that rehearing should be granted on the issue of rate case expense. The issue was not raised until the hearing in this matter. Commission Staff, not Owenton, initially raised the issue. While Tri-Village did not object to Commission Staff s request for such information, it did object to Owenton s last minute motion for rate case expense recovery.[10] While the Commission has routinely accepted post-hearing submissions regarding rate case expense, such submissions usually consist of detailed invoices. In this case, Owenton submitted cursory invoices that fail to indicate

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[9] See also Lake Village Water Association, Inc., Case No. 89-075 (Jan. 29, 1990) at 5 ( It is a long-standing policy of the Commission . . . not to allow more than 15 percent for water loss for the purpose of determining allowable expense for rate-making. This policy is intended to serve as an incentive to promote efficient management. ).

[10] Owenton did not formally request recovery of its rate case expenses until January 25, 1999. Tri-Village subsequently filed written objections to that request on February 5, 1999.

the nature or amount of work performed. Given the lack of detail and the limited opportunity for review, we find that Tri-Village did not have a meaningful opportunity to address this issue and should be afforded such opportunity on rehearing.

Having considered the application for rehearing and response thereto and being otherwise sufficiently advised, the Commission HEREBY ORDERS that:

1. Tri-Village s application for rehearing on the issue of rate case expense is granted.

2. Tri-Village s application for rehearing on all other issues is denied.

3. Within 10 days of the date of this Order, Owenton shall file with the Commission and serve upon Tri-Village detailed invoices of its rate case expenses. These invoices shall, at a minimum, identify the services for which Owenton was billed, the hourly rate for such services, and the number of hours worked.

4. Within 20 days of the date of this Order, Tri-Village shall file with the Commission and serve upon Owenton written interrogatories and requests for production of documents. The subject matter of such requests shall be limited to Owenton s rate case expenses.

5. Within 40 days of the date of this Order, Owenton shall file with the Commission and serve upon Tri-Village its responses to written interrogatories and requests for production of documents.

6. Within 60 days of the date of this Order, each party shall file with the Commission a written brief on the issue of rate case expenses and the appropriate allocation of such expenses.

7. Within 75 days of the date of this Order, each party may file a reply brief with the Commission addressing the arguments raised in the opposing party s brief.

Done at Frankfort, Kentucky, this 5th day of April, 1999.

By the Commission

ATTEST:

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Executive Director

APPENDIX A

AN APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 98-283 DATED APRIL 5, 1999

| 1997 Expense | Total System | Joint Treatment Allocation | Allocation of Treatment Expense | Joint Distribution Allocation | Allocation of Distribution Expense |
|---|---|---|---|---|---|
| Bad Debt | 2,987 | 0 | 0 | 0 | 0 |
| Chemicals | 39,799 | 39,799 | 22,900 | 0 | 0 |
| Electricity | | | | | |
| River Pumping Facilities | 25,582 | 25,582 | 14,720 | 0 | 0 |
| Water Treatment Plant | 22,690 | 22,690 | 13,056 | 0 | 0 |
| Truck Loading Station | 432 | 0 | 0 | 0 | 0 |
| Tank Telemetry | 175 | 0 | 0 | 175 | 62 |
| Insurance | | | | | |
| Employee | 11,733 | 7,274 | 3,890 | 4,459 | 1,570 |
| Workers Comp | 7,445 | 4,616 | 2,469 | 2,829 | 996 |
| Truck | 5,165 | 3,202 | 1,712 | 1,963 | 691 |
| Building | 1,631 | 1,631 | 872 | 0 | 0 |
| Bond | 523 | 0 | 0 | 0 | 0 |
| Misc. | 516 | 311 | 166 | 205 | 72 |
| Office Expense | 4,286 | 2,586 | 1,383 | 1,700 | 599 |
| Operating Supplies | 3,425 | 3,425 | 1,832 | 0 | 0 |
| Payroll Expenses | 10,747 | 6,663 | 3,563 | 4,084 | 1,438 |
| Professional Fees | 3,800 | 2,292 | 1,226 | 1,508 | 531 |
| Repairs and Maintenance | | | | | |
| Distribution Materials | 26,142 | 0 | 0 | 26,142 | 9,207 |
| Service Facilities | 8,010 | 0 | 0 | 0 | 0 |
| Treatment Plant | 14,746 | 14,746 | 7,886 | 0 | 0 |
| Miscellaneous | 6,395 | 1,929 | 1,032 | 4,466 | 1,573 |
| Retirement Contributions | 6,607 | 4,096 | 2,191 | 2,511 | 884 |
| Salaries and Wages | | | | | |
| Distribution | 36,651 | 0 | 0 | 36,651 | 12,908 |
| Treatment | 77,464 | 77,464 | 41,428 | 0 | 0 |
| Meters | 22,283 | 0 | 0 | 0 | 0 |
| Sampling Expense | 3,676 | 0 | 0 | 3,676 | 1,295 |
| Telephone | 1,547 | 933 | 499 | 614 | 216 |
| Tractor and Truck | 7,502 | 4,526 | 2,421 | 2,976 | 1,048 |
| Travel and School | 1,153 | 715 | 382 | 438 | 154 |
| Uniforms | 2,653 | 1,645 | 880 | 1,008 | 355 |
| Withdrawal Fees | 5,420 | 0 | 0 | 0 | 0 |
| Depreciation | | | | | |
| Buildings and Improvements | 333 | 0 | 0 | 333 | 117 |
| Office Furniture and Fixtures | 804 | 485 | 259 | 319 | 112 |
| Distribution System | 40,857 | 0 | 0 | 40,857 | 14,390 |
| Equipment | 9,993 | 0 | 0 | 9,993 | 3,520 |
| Service Facilities | 1,243 | 0 | 0 | 0 | 0 |
| Treatment Plant | 45,457 | 45,457 | 24,310 | 0 | 0 |
| Miscellaneous | 125 | 125 | 0 | 67 | 24 |
| Total Operating Expenses | $ 459,997 | $ 272,192 | $ 149,077 | $ 146,974 | $ 51,764 |
| Rates | | | *$1.44* | | *$0.50* |
| Treatment Rate | | | *$1.44* | | |
| Distribution Rate | | | *$0.50* | | |
| Debt Service Rate | $ 17,591 | | *$0.17* | | |
| **Wholesale Rate to Tri-Village** | | | **$2.11** | | |