

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ADJUSTMENT OF THE RATES OF KENTUCKY )  
TURNPIKE WATER DISTRICT AND THE IMPOSITION ) CASE NO. 98-398  
OF AN IMPACT FEE )

ORDER

Kentucky Turnpike Water District ( Kentucky Turnpike ) has applied for a 15 percent increase in its rates for water service within its Division II. By this Order, the Commission grants the proposed rate adjustment and authorizes rates that will increase Kentucky Turnpike s annual revenues by \$101,729.

PROCEDURE

On September 1, 1998, Kentucky Turnpike applied for authority to increase its rates for water service within its Division II service area by \$73,655 over test year operating revenues, or approximately 10 percent.<sup>1</sup> Kentucky Turnpike subsequently amended its application to request a 15 percent increase in retail rates.

On September 11, 1998, the Commission found that further proceedings were necessary to investigate the reasonableness of Kentucky Turnpike s proposed rates and suspended those rates for a period of five months. The Commission permitted the following parties to intervene in this matter: Burke Realty Company, Inc. ( Burke

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<sup>1</sup> Kentucky Turnpike submitted its application on July 7, 1998. Pursuant to Administrative Regulation 807 KAR 5:001, Section 2, the Commission s Executive Director found that the water district s filing failed to comply with Administrative Regulation 807 KAR 5:001, Section 10, and rejected the application. On September 1, 1998, Kentucky Turnpike cured these filing deficiencies.

Realty ), John Miller, Richard Haarman, and Harold and Karen Smith. After permitting extensive discovery in this matter, the Commission held a public hearing on the proposed rate adjustment on April 26, 1999.<sup>2</sup> Burke Realty and Kentucky Turnpike submitted written briefs following the hearing.

#### COMMENTARY

Kentucky Turnpike is a water district organized pursuant to KRS Chapter 74. It currently provides water service to approximately 5,415 customers in portions of Bullitt County, Kentucky. The water district is divided into two operating divisions. Division I covers northern Bullitt County. Louisville Water Company operates Division I's facilities under a lease agreement which was executed in 1967. Division II serves approximately 2,083 customers who are located in the remaining portions of Bullitt County.<sup>3</sup> It represents the remnants of the Salt River Water District that merged into Kentucky Turnpike in 1992. Kentucky Turnpike exercises full management and operational control over Division II's facilities.

#### TEST PERIOD

Kentucky Turnpike proposes, and the Commission accepts, the 12-month period ending December 31, 1997 as the test period for determining the reasonableness of the

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<sup>2</sup> The following persons testified at this hearing: Raymond Abell, Kentucky Turnpike's District Manager; J. Stephen Freeman, a certified public accountant; and Martin L. Brown, Senior Vice President of GEM Capital Corporation. Karen Smith, a former member of Kentucky Turnpike's Board of Commissioners, submitted written testimony but did not appear at the hearing. The parties stipulated to the admission of her written testimony into the record.

<sup>3</sup> Kentucky Turnpike's Response to the Commission's Order of March 8, 1999, Response 5.

proposed rates. In using this historic test period, the Commission gives full consideration to appropriate known and measurable changes.

### REVENUES AND EXPENSES

Kentucky Turnpike reports test-period income before debt service of \$144,119.<sup>4</sup> It proposes several adjustments to test-year operations to reflect normalized operating conditions. The Commission finds that, with the exceptions noted below, these adjustments are reasonable and in accordance with accepted rate-making principles.

#### Revenue from Water Sales

Kentucky Turnpike reports test-year operating revenue from water sales as \$729,362. It proposes to adjust operating revenue to reflect changes in the number of residential and commercial customers and the addition of North Nelson Water District as a wholesale customer.<sup>5</sup> The Commission finds the proposed adjustments are reasonable. Based upon the billing analysis which is set forth in Table I and which reflects Kentucky Turnpike's proposed adjustments to operating revenue, the Commission finds that Kentucky Turnpike's normalized test-year revenue from water sales is \$830,586.

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<sup>4</sup> Kentucky Turnpike's Application at App. 4.

<sup>5</sup> Id. at 3 and App. 4. See also Kentucky Turnpike's Response to the Commission's Order of October 5, 1998, Item 6.

**TABLE I**

METER SIZE	BILLS	GALLONS	REVENUE
5/8" and 3/4"	10,445	99,284,244	\$526,697.77
1"	318	10,122,200	42,178.37
1 - 1/2"	12	6,015,300	19,039.47
2"	65	10,856,700	36,497.86
3"	13	9,202,400	28,995.18
4"	18	6,999,800	22,594.30
6"	6	808,000	2,736.36
Wholesale	6	52,677,000	73,747.80
North Nelson Water District.	6	48,000,000	94,560.00
TOTAL	10,889	243,965,644	\$847,047.11
Less Commercial Customers		(4,203,180)	(16,460.68)
Normalized Test Year Operating Revenue		239,762,464	\$830,586.43

Purchased Water Expense

Kentucky Turnpike reports purchased water expense of \$275,285 for the test period. It proposes a net increase of \$56,723 in this expense to reflect purchased water expense for 94 additional residential customers, 15 fewer commercial customers, and 1 additional wholesale customer. As shown in Table II, the Commission has determined Kentucky Turnpike's normalized purchased water expense to be \$323,979, an increase of \$48,694 over test-period purchased water expense.

**TABLE II**

Normalized Test Year Usage	239,762,464 gallons
Adjusted for 10% Line Loss <sup>6</sup>	÷ .90
Equals: Allowable Purchased Water for Resale	266,402,738 gallons
Plus: Water Used by Company	+12,889,750 gallons
Equals: Total Purchased Water	279,292,488 gallons
Current Purchased Water Rate	x .00116 per gallon
Allowed Purchased Water Expense	<u>\$ 323,979.00</u>

In calculating purchased water expense, the Commission has excluded the cost of water provided to local fire departments at no charge. Kentucky Turnpike reports that

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<sup>6</sup> See Annual Report of Kentucky Turnpike Water District Division II for the Year Ended December 31, 1997 at 32.

6,448,550 gallons of water was provided to the Southeast Bullitt Fire District and the City of Shepherdsville Fire Department at no charge.<sup>7</sup> KRS 278.035 prohibits preferential retail rates for certain entities receiving public funds. Free or reduced rate service for the purpose of fighting fires or training firefighters is exempted from this restriction provided prior Commission approval is obtained and the service is provided under a tariff that requires the water user to maintain estimates of the amount of water used for fire protection and training, and to report this water usage . . . on a regular basis. KRS 278.170(3). Kentucky Turnpike concedes that its filed tariffs do not contain such provisions.<sup>8</sup> Its provision of such service, therefore, is contrary to KRS 278.035 and 278.170. The Commission finds that Kentucky Turnpike's ratepayers should not be required to bear the expenses associated with this conduct.

#### Administrative Expense

In its application, Kentucky Turnpike reports test-year administrative expenses of \$185,698. It proposes to adjust this expense by \$22,000 to reflect the amortization of legal and financial consulting fees incurred in this and other Commission proceedings.<sup>9</sup> The water district characterizes these expenses as extraordinary expenses that should be amortized over a three-year period.

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<sup>7</sup> Id. See also Kentucky Turnpike Water District's Response to the Commission's Order of December 15, 1999, Item 6.

<sup>8</sup> Kentucky Turnpike's Response to the Commission's Order of November 13, 1998, Item 19.

<sup>9</sup> Case No. 97-323, Burke Realty Company, Inc. v. Kentucky Turnpike Water District; Case No. 97-441, Sam Hardy v. Kentucky Turnpike Water District.

Burke Realty objects to the proposed adjustment on two grounds. It first argues that Kentucky Turnpike failed to obtain the Bullitt County Judge/Executive's approval to retain the law firm of Stites and Harbison as its legal counsel in violation of KRS 278.030.<sup>10</sup> Burke Realty further argues that Kentucky Turnpike unreasonably incurred these legal fees since the Bullitt County Attorney was available to represent the water district at no charge.

The evidence of record fails to support Burke Realty's contention that Kentucky Turnpike violated KRS 278.030. In April 1990, the Bullitt County Fiscal Court unanimously approved Kentucky Turnpike's decision to retain their [sic] own private legal counsel provided that the legal fees be paid out of their district funds and none to be paid out of County funds.<sup>11</sup> This approval contained no time limitations or any restrictions on the manner in which the water district may retain counsel. There is no evidence that succeeding Bullitt County Fiscal Courts or Bullitt County Judge/Executives rescinded or revoked this approval.

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<sup>10</sup> KRS 278.030 provides:

The county attorney shall act as counsel to the water commission, except that the commission may, subject to approval of the county judge/executive, employ counsel whose compensation shall be paid from water district funds.

<sup>11</sup> Kentucky Turnpike's Response to Burke Realty's Motion to Compel PSC to Require Proof of Approval of the Hiring of Stites & Harbison, Exhibit 1.

Burke Realty has questioned whether the actions of an earlier Bullitt County Fiscal Court and County Judge/Executive can bind their successors. It argues that the 1990 approval should not be considered open ended and should not be binding upon succeeding Bullitt County Judge/Executives. Kentucky Turnpike, it argues, was required to seek approval of succeeding Bullitt County Judge/Executives.

KRS 74.030, however, does not support this interpretation. It does not require that approval for the employment of private legal counsel be submitted to each succeeding county judge/executive. Moreover, nothing prevents a county judge from rescinding his predecessor's approval or limiting or restricting such approval. The record shows that succeeding Bullitt County Judge/Executives were aware of the water district's employment of private legal counsel and took no action to restrict that employment. Their knowing acquiescence strongly suggests approval of the water district's actions.

The record fails to show that Kentucky Turnpike acted unreasonably by retaining private legal counsel instead of seeking the services of the Bullitt County Attorney. The selection of legal counsel is an action well within the discretion of utility management. In exercising its discretion, utility management must take into account several factors including the resources, experience, specialized expertise and workload of prospective counsel. There is no evidence that Kentucky Turnpike abused this discretion. The record fails to reflect that the Bullitt County Attorney was available and willing to represent the water district in these matters. Nor is there any evidence as to the level of the Bullitt County Attorney's knowledge or experience in the area of public utility law.

Kentucky Turnpike presented invoices for legal and financial consulting fees in the amount of \$86,503.<sup>12</sup> Approximately \$83,819 of these fees concern legal services from Stites and Harbison. Having reviewed the fees in question, the Commission finds that expenses of \$8,544 are related to this rate adjustment proceeding, are reasonable, and should be amortized over three years. We further find that expenses of \$75,275 involving other Commission proceedings and general legal representation are reasonable regulatory expenses and should be subject to a three-year amortization period. Finally, we find that Kentucky Turnpike has failed to demonstrate the purpose or nature of certain payments to GEM Capital totaling \$2,685 and therefore have excluded those expenses for rate-making purposes.

#### Principal Amortized

In its application, Kentucky Turnpike proposes to include principal amortized to determine total operating expenses. Principal payments are not considered as operating expenses. To the extent that current principal payments are considered when determining Kentucky Turnpike's annual debt service payments, the Commission addresses this issue below.

#### Depreciation Expense

Burke Realty has questioned whether Kentucky Turnpike properly accounted for the purchase of a Jeep Cherokee vehicle.<sup>13</sup> Having reviewed the evidence of record, the

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<sup>12</sup> Kentucky Turnpike Water District's Response to the Commission's Order of October 5, 1999, Item 9. Kentucky Turnpike Water District's Response to the Commission's Order of December 15, 1999, Item 4.

<sup>13</sup> Post Hearing Brief of Burke Realty Company, Inc. at 13-14.



Commission finds that Kentucky Turnpike correctly capitalized and depreciated the vehicle s cost.

#### Gain on Sale of Fixed Assets

During the test year Kentucky Turnpike realized a gain of \$10,432 on the sale of a fixed asset. Characterizing this transaction as a non-recurring transaction, Kentucky Turnpike proposes an adjustment to reduce test-period operations by the amount of the realized gain. The Commission finds that the proposed adjustment is reasonable and has excluded the gain from the calculation of the District s revenue requirement.

#### Interest Income

Kentucky Turnpike earned interest income of \$20,407 during the test year. The use of \$8,189 of this interest income is restricted to the retirement of the water district s outstanding Kentucky Infrastructure Authority ( KIA ) loan and cannot be used to meet the on-going expenses of the utility.<sup>14</sup> Accordingly, the Commission has decreased test-year interest income to a level of \$12,218.

#### Summary

Kentucky Turnpike s adjusted test-year operations are summarized below in Table III:

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<sup>14</sup> Kentucky Turnpike s Response to the Commission s Order of November 13, 1998, Item 4(b).

TABLE III

	<u>Test Year</u>	<u>Adjustments</u>	<u>Proposed Test Year Adjusted</u>
Operating Revenues			
Residential Metered Sales	463,846	23,125	486,971
Commercial Metered Sales	265,516	(16,461)	249,055
North Nelson WD Sales	-	<u>94,560</u>	<u>94,560</u>
Total Metered Sales	<u>729,362</u>	<u>101,224</u>	<u>830,586</u>
Other Operating Revenues	<u>8,243</u>	-	<u>8,243</u>
Total Operating Revenues	737,605	101,224	838,829
Operating Expenses			
Purchased Water	275,285	48,694	323,979
Administrative Expense	185,698	-	185,698
Maintenance Expense	17,644	-	17,644
Depreciation Expense	139,133	897	140,030
Amortization Rate Case Expense		2,848	2,848
Amortization Other Regulatory Expense		25,091	25,091
Amortization Debt Discount & Expense	<u>6,565</u>	-	<u>6,565</u>
Total Operating Expenses	<u>624,325</u>	<u>77,530</u>	<u>701,855</u>
Operating Income	113,280	23,694	136,974
Other Income & Expense			
Interest Income	20,407	(8,189)	12,218
Gain on sale of Fixed Assets	<u>10,432</u>	<u>(10,432)</u>	-
Income Available for Debt Service	<u>144,119</u>	<u>5,073</u>	<u>149,192</u>

REVENUE REQUIREMENTS DETERMINATION

In determining Kentucky Turnpike s revenue requirements, the Commission has included the annual debt service requirements for Kentucky Turnpike s long-term loan with KIA. The average annual debt service for this loan is \$101,721.<sup>15</sup>

Kentucky Turnpike proposes to include principal and interest on a two year bond anticipation note that it issued to cover the Cedar Grove Road Transmission Main s construction costs. While recognizing that Kentucky Turnpike failed to obtain a certificate of public convenience and necessity prior to constructing this facility, the Commission finds that the water main is necessary for Kentucky Turnpike to meet its

<sup>15</sup> Kentucky Turnpike s Response to the Commission s Order of December 15, 1998, Item 1.

contractual commitments to North Nelson Water District and to provide water service to customers within the Cedar Grove Road area and that the cost of servicing this debt should be recovered in Kentucky Turnpike s rates. Using the projected debt service requirements for the bonds that the water district will issue to retire these bond anticipation notes, the Commission has determined that the average annual debt service for this debt is \$114,656.<sup>16</sup>

The Commission finds that Kentucky Turnpike s annual revenue requirement is \$972,326<sup>17</sup> and requires an increase in revenue from retail water service rates of \$121,279.<sup>18</sup> Kentucky Turnpike s requested rates would produce annual revenues from water sales of \$932,315, as Table IV shows below. Interest income and other operating revenues amount to \$20,461 resulting in total revenue from retail water service of \$952,776, an increase of \$101,729. The Commission further finds that Kentucky Turnpike s proposed rates would result in a positive cash flow of \$72,806<sup>19</sup> and that their implementation would not cause Kentucky Turnpike s service to suffer.

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<sup>16</sup> Id.

<sup>17</sup> Adjusted Operating Expenses	\$701,855
Average Annual Debt Service	216,377
.25 Debt Service Coverage	<u>54,094</u>
Total Revenue Requirement	<u>\$972,326</u>

<sup>18</sup> Total Revenue Requirement	\$972,326
Less: Normalized Operating Revenues from Rates	830,586
Other Operating Revenues	8,243
Interest Income	<u>12,218</u>
Required Increase	<u>\$ 121,279</u>

<sup>19</sup> Proposed Increase	\$(101,729)
Add back non-cash expenses:	
Depreciation Expense	140,030
Amortization Expense	<u>34,505</u>
Positive Cash Flow	<u>\$ 72,806</u>

**TABLE IV**

<b>METER SIZE</b>	<b>BILLS</b>	<b>GALLONS</b>	<b>REVENUE</b>
5/8" and 3/4"	10,445	99,284,244	\$605,703.15
1"	318	10,122,200	48,513.24
1 - 1/2"	12	6,015,300	21,877.59
2"	65	10,856,700	41,949.73
3"	13	9,202,400	33,316.00
4"	18	6,999,800	25,963.11
6"	6	808,000	3,145.84
Wholesale	6	52,677,000	73,747.80
North Nelson Water District.	6	48,000,000	94,560.00
<b>TOTAL</b>	<b>10,889</b>	<b>243,965,644</b>	<b>\$948,776.46</b>
Less Commercial Customers		(4,203,180)	(16,460.68)
Normalized Test Year Operating Revenue		239,762,464	\$932,315.78

**RATE DESIGN**

Kentucky Turnpike proposes no revisions to its current declining block rate design, but instead requests an across-the-board percentage increase for its retail customers. It has not provided any cost-of-service study to demonstrate the reasonableness of its current rate design or to show that its proposed rates are cost based.

When a utility applies for a rate adjustment, the Commission normally requires the utility to support the proposed rates with a cost-of-service study. We recognize, however, that existing conditions made the preparation of such a study difficult. Kentucky Turnpike has several extension projects in progress that may significantly affect its rates. It has also executed but not implemented a wholesale water supply contract with North Nelson Water District and is negotiating to provide wholesale service to the city of Lebanon Junction. The usage patterns for these wholesale contracts have yet to be established. In light of these events, a cost-of-service study will not ensure an accurate allocation of cost. The Commission will therefore accept Kentucky Turnpike's

current rate design. The Commission places Kentucky Turnpike on notice that in its next rate proceeding a cost-of-service study will be required and that revisions may be made to its rate design.

#### NON-RECURRING CHARGE

Kentucky Turnpike proposes in its application to revise its meter connection fee for 5/8-inch meters from \$450.00 to the actual cost of connection. It contends that the geographical terrain of its service area varies greatly and causes significant variations in the cost of meter connections. When connections are made in certain portions of the water district's service territory, the water district recovers significantly less than its cost of installation.

The Commission has historically required that residential meter connection fees be based upon averaged costs. The Commission has followed this approach to ensure that water connection fees are affordable and that water service is available to the general public. Kentucky Turnpike has not offered any persuasive reason for deviating from this approach. Moreover, the Commission finds that the addition of a rock clause<sup>20</sup> to Kentucky Turnpike's tariff, which is designed to recover the additional cost of removing large amounts of rock when installing a line and setting a meter, is the better solution to Kentucky Turnpike's problem. The Commission will favorably consider any amendment to Kentucky Turnpike's tariff that includes such a provision.

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<sup>20</sup> See, e.g., Case No. 8521, The Tariff Filing of South Woodford County Water District Proposing Increased Meter Connection Charges (Oct. 19, 1982). Rock clauses generally contain the following language: An additional charge shall be made for meter connections where rock is encountered, such rock condition being defined as limestone or other hard stratified material in a continuous volume of at least one cubic yard or more and which cannot be removed using ordinary excavation equipment. The charge shall be applied per linear trench foot and shall not exceed the actual cost of excavation.

## SUMMARY

Having reviewed the evidence of record and being otherwise sufficiently advised, the Commission finds that:

1. Kentucky Turnpike s annual revenue requirement is \$972,326.
2. Kentucky Turnpike s requested rates, which are set forth in Appendix A, will produce annual revenues of \$932,315. When Kentucky Turnpike s interest income and other operating revenues are also considered, the water district will have annual revenues of \$952,776. Implementation of the requested rates is not likely to result in any reduction in the quality of utility service that Kentucky Turnpike renders to the public.
3. Where a utility has requested rates that are less than a regulatory commission determines would furnish a fair return then, in the absence of some factor which would in the public interest require that larger rates be charged, the rates requested by the utility ought to be allowed. Utilities Operating Co. v. King, 143 So.2d 854 (Fla. 1962).
4. Kentucky Turnpike s proposed rates for retail water service should be approved for water service rendered on and after the date of this Order.
5. Kentucky Turnpike s proposed fee for meter connection is unjust and unreasonable and should be denied.
6. Because of the changes presently occurring in Kentucky Turnpike s Division II operations, Kentucky Turnpike should apply for a rate adjustment within three years from the date of this Order. Kentucky Turnpike should file with its application a cost-of-service study that conforms to the standards of the American Water Works Association and supports the proposed rates.

IT IS THEREFORE ORDERED that:

1. The rates set forth in Appendix A are approved for service rendered by Kentucky Turnpike on and after the date of this Order.
2. Within 20 days of the date of this Order, Kentucky Turnpike shall file with the Commission revised tariff sheets setting forth the rates approved herein.
3. Kentucky Turnpike's proposed meter connection fee is denied.
4. Kentucky Turnpike shall, within three years from the date of this Order, submit an application for rate adjustment. It shall include with this application a cost-of-service study that conforms to the standards of the American Water Works Association and supports the proposed rates.

Done at Frankfort, Kentucky, this 30<sup>th</sup> day of June, 1999.

By the Commission

ATTEST:

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Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 98-398 DATED JUNE 30, 1999

The following rates and charges are prescribed for the customers in the area served by Kentucky Turnpike Water District Division II. 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.

Monthly Water Rates

5/8 and 3/4 inch connection

First	2,000 gallons	\$15.67 Minimum Bill
Next	3,000 gallons	4.75 per 1,000 gallons
Next	5,000 gallons	4.27 per 1,000 gallons
Next	15,000 gallons	4.04 per 1,000 gallons
Over	25,000 gallons	3.55 per 1,000 gallons

1 inch connection

First	5,000 gallons	\$29.92 Minimum Bill
Next	5,000 gallons	4.27 per 1,000 gallons
Next	15,000 gallons	4.04 per 1,000 gallons
Over	25,000 gallons	3.55 per 1,000 gallons

1 1/2 inch and all larger connections

First	10,000 gallons	\$51.27 Minimum Bill
Next	15,000 gallons	4.04 per 1,000 gallons
Over	25,000 gallons	3.55 per 1,000 gallons