

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE TARIFF FILING OF HENRY COUNTY WATER)	
DISTRICT NO. 2 TO ADD TARIFF LANGUAGE FOR)	CASE NO.
AN OFFSETTING IMPROVEMENT CHARGE)	2001-00393

ORDER

On November 6, 2001, Henry County Water District No. 2 (Henry District) filed with the Commission revisions to its tariff to allow for the collection of an Offsetting Improvement Charge. On November 13, 2001, the Commission entered an Order establishing this case in order to determine the reasonableness of the proposed charge. An informal conference was held on February 26, 2002 with Commission Staff, Henry District and the Office of the Attorney General (AG) attending. At the informal conference, it was determined that a hearing was unnecessary in this proceeding and all parties were given an opportunity to file briefs. On March 13, 2002, Henry District filed an amended tariff. Henry District did not file a brief. The AG filed his brief on April 15, 2002.

Henry District, a water district organized pursuant to KRS Chapter 74, owns and operates facilities that provide water service to 5,431 customers in Henry, Trimble, Oldham, Carroll, and Shelby counties, Kentucky. As of December 31, 2001, it had net utility plant of \$13,530,955. For the year ending December 31, 2001, Henry District had operating revenues of \$2,662,641, operating expenses of \$478,575, and net income of \$38,422.

In 2000, Henry District began the practice of requiring new customers to pay an Offsetting Improvement Charge as a condition to receiving service. It determined this charge by calculating the potential customer's effect on minimum daily water flow in the general vicinity of the potential customer's location and estimating the cost of facility improvements to return water pressure to its prior level. The water district determined the cost of these improvements based upon the cost of previous water main improvements or additions during a 4-year period and the increase in peak flow that resulted from these improvements. Dividing the total cost by the total increase in peak flow, Henry District calculated an offsetting charge of \$980 per gallon per minute of flow loss as a result of the addition.

Initially Henry District imposed this Offsetting Improvement Charge through special contracts. It required all customers who requested service to execute contracts that required the payment of the Offsetting Improvement Charge even in those instances where the water district's existing facilities were adequate to support the additional customers. To ensure that no revenues from the proposed Offsetting Improvement Charge would be lost while the Commission reviewed the proposed charge, Henry District has refused to certify the availability of water service to any proposed development while the Commission's review is pending.

Henry District proposes to assess the Offsetting Improvement Charge to any customer that connects to its system after the effective date of the tariff or to any real estate developer that proposes a real estate development that the water district would serve. The real estate developer would be assessed at the time the water district certifies to a planning and zoning commission that it will provide water service to the

proposed real estate development. The charge would be based upon the number of lots set forth in the proposed subdivision plans. At the time the developer requests certification, the water district would prepare a hydraulic analysis that models the expected loss in water pressure that would result from the additional customers. The developer would pay the cost of the proposed analysis as well as a charge based upon the amount of loss resulting from the proposed connections. This charge would be assessed even if existing facilities could serve the proposed real estate subdivision. For non-industrial or commercial customers who are not real estate developers, the water district would assess a charge based upon the loss of one gallon per minute of peak water flow per lot. For industrial and commercial customers, it would assess a charge based upon the loss of one gallon per minute of peak water.

The water district intends to calculate the charge based upon the cost and improvements in water flow brought by the water district's improvement projects over a 4-year period. The water district totals the cost of these projects and totals the increase in water flow that results from each of these improvements. It then divides total expenditures by total peak flow to obtain a cost per gallon per minute. This charge is then multiplied by the expected reduction in gallons per minute flow to obtain the total Offsetting Improvement Charge. All customers connecting to the system would be charged the same amount. The water district proposes to recalculate the Offsetting Improvement Charge biennially.

The following example is used to illustrate how the charge is calculated and assessed. During the past 4 years, Henry District constructed a water main improvement or extension project that cost \$30,000 and increased peak water flow

rates by 30 gallons per minute. Based upon this project, the Offsetting System Charge would be \$1,000.¹ If a real estate developer requests certification for a 20-lot subdivision, the water district would assess a charge of \$20,000.² If a commercial customer requested a connection that would reduce peak water flow by 30 gallons per minute, it would be assessed a charge of \$30,000.³

Henry District proposes to place all collected charges in an escrow account and to use monies from this account only for water line projects that improve hydraulic conditions in the distribution system. It states that it will provide the Commission with an accounting of all expenditures from the escrow account. The water district will determine the uses of the proceeds based upon hydraulic need and cost-effectiveness.

In his brief the AG asserts that Henry District's proposal falls within the definition of a system development charge.⁴ The AG further states that it appears that the goal of the Offsetting Improvement Charge is to maintain the status quo of the distribution system by affording cost recovery for development. The AG maintains that the charge does not represent an effort by the utility to recover indirectly through a surcharge an amount that is recoverable through a general rate increase. The function of the charge is not to replace or otherwise fund maintenance so that the system will continue as

¹ Total cost of the improvement projects (\$30,000) ÷ Total improvement in water flow (30 gpm) = \$1,000 per gpm.

² Offsetting Improvement Charge x Number of Lots x Loss of water flow (gpm) = \$1,000 per gpm x 20 lots x 1 gpm loss/lot = \$20,000. The development is assumed to reduce peak flow by 1 gpm per lot.

³ Offsetting Improvement Charge x Loss of water flow (gpm) = \$1,000 per gpm x 30 gpm loss = \$30,000.

⁴ AG's Brief at 4.

originally designed, but to enable the system to continue to provide adequate service despite additional customer requirements.⁵ The AG declined to offer comment regarding whether the evidence satisfies the criteria set out in Administrative Regulation 807 KAR 5:090, which governs system development charges.

The Commission agrees with Henry District that the proposed charge may reasonably be used to avoid rate increases to finance water main extensions and upsizing. In areas experiencing significant growth it is inappropriate to expect current customers to pay for demands new development places on a system.

The water main improvements funded by the proposed charge will not be limited to one area but will be located throughout the water district's service area. Henry District has stated that most of the water mains being replaced are 3-inch water mains that are being replaced by 6-inch mains. The physics of water transmission result in reduced system performance if part of the system fails, even if that part is located many miles away from the new development. Owing to the systemic nature of water systems, it is not uncommon to view the entire system as benefiting new development even though system development charges paid by new development may be expended many miles away from such development.

It is acceptable for funds collected from those who request expansion to be used to maintain a consistent level of service throughout a utility's service territory. For example, system development charges collected in service areas with excess capacity may be used to remedy deficiencies in other service areas. The use of funds in this

⁵ Id. at 5.

manner allows the utility to bring about a more uniform level of service to all areas of the water district.

Despite our general agreement with the rationale supporting the charge proposed herein by Henry District, we do have some concerns regarding the proposed tariff filing. The proposed tariff provides no means of distinguishing how the construction of system line improvements may benefit existing customers; nor does it contain a provision addressing the need to measure the effects of those improvements, or the proposed charge, upon existing customers. The proposed tariff filing also lacks controls regarding the use of proceeds of the proposed charge. Henry District has no long-term plan for the construction of water mains. It has no criteria for locating or upsizing water mains. Moreover, under the proposed plan, the district has complete discretion as to the location of new facilities. Thus, the potential for arbitrary decision-making is very high. The Commission expects Henry District to revise its tariff filing within the next 12 months to address these concerns.

We conclude that the Offsetting Improvement Charge appears to be in the public interest in that it will benefit both Henry District and its customers. However, because the proposed charge presents a case of first impression for the Commission, we believe that it should be established for an initial 3-year period only, after which we will conduct a full review of the operation of the program and determine whether it should be renewed. We also place Henry District on notice that the Offsetting Improvement Charge may not be required of applicants who have applied for service prior to the effective date of the Offsetting Improvement Charge tariff.

Finally, we note that the decision reached by the Commission in this case is, and in all future cases will be, based on the specific facts of the case before it. This decision is not, and shall not be construed as, a statement of broad general applicability.

For the foregoing reasons, we authorize a modified Offsetting Improvement Charge, as described in Appendix A. If Henry District accepts the language contained in Appendix A, it shall so notify the Commission within 10 days from the date of this Order, and it shall file its tariff in accordance with Appendix A within 30 days of the date of this Order.

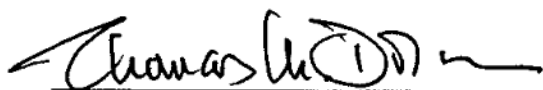
IT IS THEREFORE ORDERED that:

1. The Offsetting Improvement Charge as filed by Henry District is denied.
2. The Offsetting Improvement Charge as set out in Appendix A to this Order is hereby approved for a period of 3 years from the date of this Order.
3. Within 30 days from the date of this Order, Henry District shall, if it accepts the modifications contained in Appendix A to this Order, file its tariff in accordance with such modifications.
4. Within 12 months from the date of this Order, Henry District shall amend its Offsetting Improvement Charge tariff to include a provision for a long-range construction plan; a method to determine the benefits existing customers receive from any system improvements; and criteria to be used for locating or upsizing mains.

Done at Frankfort, Kentucky, this 25th day of July, 2002.

By the Commission

ATTEST:

A handwritten signature in black ink, appearing to read "Charles H. [unclear]", written over a horizontal line.

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2001-00393 DATED July 25, 2002

FOR _____
Community, Town or City

P.S.C. KY. NO. _____

_____ SHEET NO. _____

Henry County Water District
(Name of Utility)

CANCELLING P.S.C. KY. NO. _____

_____ SHEET NO. _____

RULES AND REGULATIONS

OFFSETTING IMPROVEMENT CHARGE

It is the policy of the District that development should pay to offset its hydraulic impact on the water distribution system, rather than such costs being paid by the District's customers. Development shall be defined as any previously unserved lot or lots, or other unserved tract of land, or any proposed commercial or industrial use of land. This rule shall not apply to lots in subdivisions for which the District has previously certified water availability. This rule shall apply equally to all areas of the District's service area, regardless of county.

Development shall be required to offset its hydraulic impact on the system's minimum daily water pressures by means of water line improvements to the distribution system. The cost of these offsetting improvements, per unit of peak flow in gallons per minute, shall be calculated biennially by the District's accountant and engineer as the average cost per unit of peak flow resulting from all hydraulic improvement projects evaluated during the preceding four years. These projects shall be evaluated in terms of their resultant improvement in minimum daily pressures and the increase in gallons per minute of peak flow which can be accommodated by virtue of these improvements. The total cost of these projects, divided by the total associated peak flow in gallons per minute, shall determine the charge per gallon per minute of peak flow to be paid by development. The results of this biennial calculation shall be submitted to the District's Board of Commissioners for their review and approval and to the Public Service Commission.

Residential development shall be charged on the basis of one gallon per minute of peak flow per lot. Water service to industrial lots shall not be provided until the Offsetting Improvement Charge has been received. The District shall not certify water availability on final plats until the charge for the entire subdivision has been received. If the number of plats is revised at a later date the utility shall refund any overcollection. In addition, if the improvements paid by the

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developer have the effect of restoration above 30 p.s.i., the developer shall receive an offsetting credit for such excess.

Commercial and Industrial developments shall be evaluated by a specific engineering analysis of their peak flow, to which the gallon per minute charge shall be applied. Water service to Commercial and Industrial developments shall not be provided until the charge has been received.

All developments shall require a preliminary hydraulic analysis to identify offsetting improvement projects. These projects shall be added to the database of hydraulic improvements for biennial average calculation of the offsetting improvement charge per gallon per minute of peak flow.

Offsetting improvement charges shall be placed in an escrow account and shall be used only for water line projects which improve hydraulic conditions in the distribution system. At the end of each year the District shall submit to the Public Service Commission a list of all offsetting improvement charges collected, and an accounting of all expenditures from said escrow account for hydraulic improvement projects. Such projects shall be prioritized by the District on the basis of hydraulic need and cost effectiveness.

The offsetting improvement charge shall apply in cases where the proposed development would not reduce pressures below the required 30 psi state minimum. In cases where pressures would be reduced below the minimum level, the developer shall make improvements to the distribution system to the extent necessary to specifically offset the developers impact. Such improvements shall be made by the developer in lieu of the offsetting improvement charge.

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RULES AND REGULATIONS

Each year the district shall supply the Public Service Commission with a written long term plan for the use of proceeds from the offsetting improvement charge. The water main improvement plan shall identify needed improvements to maintain pressure and a ranking in order of priority given to the improvement.

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