

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF NORTHERN KENTUCKY)	
WATER DISTRICT FOR APPROVAL OF)	CASE NO.
FINANCING THE ACQUISITION OF THE)	2002-00066
CITY OF NEWPORT WATERWORKS)	

O R D E R

On February 28, 2002, Northern Kentucky Water District (Northern Kentucky) submitted its application seeking Commission approval for the financing of the acquisition of the city of Newport water system (Newport facilities) and any other approval necessary.

By its Order in Case No. 2001-00198,¹ the Commission authorized Northern Kentucky to issue bonds in the amount of \$46,045,000 at an interest rate that will vary between 2.7 percent and 5.0 percent per annum. The Commission directed Northern Kentucky to use \$28,945,000 of its bond proceeds to refinance the Kenton County Water District No. 1 Revenue Bonds 1992, Series A and the remaining \$17,100,000 to permanently fund the existing Bond Anticipation Notes (BANs). However, the Commission found that if the agreement to acquire the Newport facilities is consummated prior to the retirement of the BANs, then Northern Kentucky would be permitted to request approval to use the \$17,100,000 of bond proceeds for the acquisition of the Newport facilities.

¹ Case No. 2001-00198, Application of Northern Kentucky Water District for Approval to Refinance Revenue Bonds in the Approximate Amount of \$38,425,000, Order dated January 8, 2002.

On February 26, 2002, Northern Kentucky and the city of Newport entered into an Asset Acquisition Agreement, wherein Northern Kentucky agreed to purchase the Newport facilities for \$17,100,000. According to a cash flow analysis provided by Northern Kentucky, the revenues from the asset purchase justify the acquisition. However, Northern Kentucky claims that the treatment plant capacity that would be immediately available upon the transfer of the Newport facilities is the primary reason for the acquisition.²

Because of the rapid growth in its service area and the desire to provide water service to as many residents as possible, Northern Kentucky claims that it must constantly review supply capabilities and assess its future needs. The options Northern Kentucky considered were to construct a new treatment plant or to acquire an existing facility.³ Northern Kentucky's analysis shows that a new treatment plant will cost \$64,740,000, but by purchasing the Newport facilities rather than constructing a new treatment plant, there will be a net present value saving to Northern Kentucky's ratepayers of \$34,741,446.⁴

Northern Kentucky states that by purchasing Newport's 10 mgd treatment plant, it is able to defer the construction of a new treatment plant for an estimated 20 plus years. Because of the timing of the acquisition, Northern Kentucky further states that it

² Response to Item 6 of the Commission Staff's Interrogatories and Requests for Production of Documents, dated March 26, 2002.

³ Id., Response to Item 14.

⁴ Id., Response to Item 6.

is able to finance the acquisition with refinanced bonds and that, therefore, Northern Kentucky's customers rates will not increase as a result of the acquisition.⁵

The Commission, having considered the evidence of record and being otherwise sufficiently advised, finds that Northern Kentucky's proposal to use \$17,100,000 of the bond proceeds approved in Case No. 2001-00198 for the purchase of the Newport facilities is for a lawful object within its corporate purpose, and is necessary or appropriate for and consistent with the proper performance of its service to the public.

When recording the purchase of the Newport facilities, Northern Kentucky proposes to value the assets at the purchase price of \$17,100,000.⁶ According to Northern Kentucky, it is not proposing to recover a plant acquisition adjustment, because the value derived from the Newport facilities is substantially greater than the reported book value.⁷

The Uniform System of Accounts for Class A and B Water Districts and Associations (USoA) requires utilities to account for new constructions or acquisitions in the following manner:

The detailed utility plant accounts (301 to 348, inclusive) shall be stated on the basis of cost to the utility of plant constructed by it and the original cost, estimated if not known, of plant acquired as an operating unit or system. The difference between the original cost, as above, and the cost to the utility of utility plant after giving effect to any accumulated depreciation or amortization, and contributions in aid of construction applicable to the property acquired, if recorded by the accounting utility at the time of acquisition, shall be recorded in account 114 Utility Plant Acquisition Adjustment.⁸

⁵ Id.

⁶ Id., Response to Item 1.

⁷ Id., Response to Item 8.

⁸ At 18 and 19.

In its Comprehensive Annual Financial Report for the year ended June 30, 2001, the city of Newport reports that its Water Works Fund has fixed assets of \$18,805,273 and accumulated depreciation of \$7,116,274 for a net fixed asset balance of \$11,688,999. According to Northern Kentucky, the city of Newport does not reflect contributions in aid of construction (CIAC) as a separate accounting entry⁹ and CIAC is not listed as a separate line item in the city of Newport's June 30, 2001 Comprehensive Annual Financial Report. Subtracting the net fixed asset balance of \$11,688,999 from the acquisition cost of \$17,100,000, results in a utility plant acquisition adjustment of \$5,411,001.

Given the purchase price and balances reported in the city of Newport's Comprehensive Annual Financial Report for the year ended June 30, 2001, the Commission finds, in accordance with the USoA, that Northern Kentucky's journal entry recording the purchase of the Newport facilities should be as follows:

<u>Description</u>	<u>Debit</u>	<u>Amount</u>	<u>Credit</u>
Utility Plant In Service	\$	18,805,273	
Plant Acquisition Adjustment	\$	5,411,001	
Accumulated Depreciation			\$ 7,116,274
Cash for Newport Purchase			\$ 17,100,000

The Commission further finds that the rate-making treatment of the plant acquisition adjustment and any associated costs (i.e.; amortization and debt service) should be deferred until Northern Kentucky's next rate case proceeding.

⁹ Response to Item 5 of the Commission Staff's Interrogatories and Requests for Production of Documents, dated March 26, 2002.

IT IS THEREFORE ORDERED that:

1. Northern Kentucky is authorized to use \$17,100,000 of the bond proceeds approved in Case No. 2001-00198 for the purchase of the Newport facilities.
2. Northern Kentucky shall obtain approval from the Commission prior to using its bond proceeds for any purpose not expressly authorized by the Commission.
3. Northern Kentucky shall record the purchase of the Newport facilities in the manner as prescribed herein.
4. The rate-making treatment of the plant acquisition adjustment and any associated costs (i.e.; amortization and debt service) shall be deferred until Northern Kentucky's next rate case proceeding.

Nothing contained herein shall be construed as a finding of value for any purpose or as a warranty on the part of the Commonwealth of Kentucky or any agency thereof as to the securities authorized herein.

Done at Frankfort, Kentucky, this 16th day of April, 2002.

By the Commission

ATTEST:


Executive Director