

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF BOONE COUNTY WATER )	CASE NO.
DISTRICT FOR AN ADJUSTMENT OF RATES)	2002-00295

O R D E R

On October 29, 2002, Boone County Water District ( Boone ) submitted an application to adjust its water rates pursuant to KRS 278.180 and 807 KAR 5:001. The application was considered filed on January 2, 2003, when all filing deficiencies were cured. Boone chose the 12 months ended July 31, 2002 as its test year. Test-year revenues from rates were reported at \$5,659,710. The proposed rates will generate additional revenues of \$2,225,371, an increase of 39.32 percent over test-year revenue.

The need for the increase in revenue is a direct result of Boone switching wholesale water suppliers. On or about March 2, 2003,<sup>1</sup> Boone will cease all purchases from Northern Kentucky Water District ( NKWD ) through a termination agreement<sup>2</sup> and begin purchasing water from the Boone-Florence Water Commission ( BFWC ), which will purchase water from Cincinnati Water Works ( CWW ). Boone s decision to switch wholesale suppliers was investigated by this Commission in Case No. 2000-00206. In that case the Commission determined that:

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<sup>1</sup> Application at 2.

<sup>2</sup> The Commission approved the termination agreement between NKWD and Boone in Case No. 2000-00206, An Investigation of Boone County Water District s Decision to Change Water Suppliers and of the Amendment of Water Supply Agreements Between Northern Kentucky Water Service District and Boone County Water District and the City of Florence, Kentucky.

1. NKWD lacks capacity to meet projected maximum daily demands of retail and wholesale customers.<sup>3</sup>

2. Selection of a water supplier is a matter of management discretion and does not require Commission approval.<sup>4</sup>

3. Through KRS 74.510 the rate and service provisions of the wholesale supply agreement between Boone and BFWC are expressly exempt from Commission regulation.<sup>5</sup>

4. The water supply agreement between BFWC and CWW is not within this Commission's jurisdiction.<sup>6</sup>

5. The Commission was not able to determine whether the switch in water suppliers will result in reasonable water costs over the life of the water supply agreement.<sup>7</sup> The Commission did find that the change in suppliers would produce reasonable water costs during the agreement's initial years<sup>8</sup> with the wholesale rate starting at \$2.13 per 1,000 gallons.<sup>9</sup>

6. Although neither the wholesale supply agreement nor the water supply agreement requires Commission approval, the Commission has the authority to adjust

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<sup>3</sup> Case No. 2000-00206, final Order dated November 9, 2002, at 13.

<sup>4</sup> Id. at 10.

<sup>5</sup> Id. at 11.

<sup>6</sup> Id. at 12.

<sup>7</sup> Id. at 16.

<sup>8</sup> Id. at 19.

<sup>9</sup> Id., Appendix A.

Boone's rates to the extent that either of the agreements are unreasonable or imprudent and adversely affect Boone's rates or quality of service.<sup>10</sup>

7. The termination agreement between Boone and NKWD requiring Boone to pay NKWD for lost debt service payments was reasonable.<sup>11</sup>

The switch in wholesale providers will increase Boone's wholesale rate from \$1.44 per 1,000 gallons to \$2.65. Generally, a water district is allowed to pass an increase in a wholesale supplier's rate on to its customers through the provisions of 807 KAR 5:068. However, 807 KAR 5:068 does not allow an automatic pass through where there is a change in the wholesale supplier. Nor does it allow for any deviation.

In this case Boone has filed its application pursuant to 807 KAR 5:001, Section 10, using a historical test period while calculating the proposed rates using the methodology provided in 807 KAR 5:068. Boone supports its approach stating that: (1) it cannot absorb the increased costs of wholesale water; (2) it is increasing rates sufficient to cover only the increased purchased water costs;<sup>12</sup> (3) it is not proposing a new rate design;<sup>13</sup> and (4) in Case No. 2000-00206 the Commission approved the termination of service agreement between Boone and NKWD.<sup>14</sup>

While Boone's rates cannot be adjusted pursuant to 807 KAR 5:068, nothing precludes this Commission from applying the purchased water adjustment methodology

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<sup>10</sup> Id. at 13.

<sup>11</sup> Id. at 21.

<sup>12</sup> Application at 4, Item 12.

<sup>13</sup> Application, Exhibit 5 at 5, Question 6.

<sup>14</sup> Application at 2, Item 2.

when adjusting rates pursuant to 807 KAR 5:001. Section 14 of 807 KAR 5:001 specifically provides for deviation where good cause is shown. The Commission finds that good cause has been shown in this case and that the proposed methodology is appropriate.

Boone cannot absorb the increase in purchased water costs through its existing rates. Appendix A of this application details Boone's coverage ratios for the test year and 5 previous years. The coverages for those years range from a high ratio of 185 percent in 1999 to a low of 98 percent in the test year. Boone's 1992 Bond Resolution requires a ratio of 125 percent.<sup>15</sup> Based on test-year purchases of 1,833,373,300 gallons, Boone's test-year expenses will increase by \$2,218,382.<sup>16</sup> With the test-year coverage ratio already below that required by Boone's Bond Resolution, Boone cannot absorb such an increase in operating expenses. Even in 1999, when Boone experienced its highest coverage ratio of the years reviewed, the excess revenue totaled \$258,697, which is not enough to absorb the increase in purchased water costs.

Boone has not filed a cost-of-service study seeking to adjust its current rate structure. It is simply applying the increase in revenues evenly to its existing rate structure. The Commission has already approved the termination agreement between Boone and NKWD, and Boone cannot absorb the change in the wholesale rate. The Commission therefore finds that Boone's method of calculating the proposed rates is reasonable.

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<sup>15</sup> Application, Exhibit 5 at 7.

<sup>16</sup> Gallons purchased (000 s omitted)	1,833,373.30
Times: Wholesale rate increase (\$2.65-\$1.44)	<u>\$1.21</u>
Increase in annual expense	<u>\$2,218,381.69</u>

The Commission is concerned that the wholesale rate sought to be passed through in this case is \$2.65 per 1,000 gallons when the anticipated wholesale rate to be charged by BFWC in Case No. 2000-00206 was not to exceed \$2.13. As noted in Case No. 2000-00206, the wholesale rate of BFWC is not subject to Commission review; however, the Commission can adjust Boone's retail rates so that any unreasonable wholesale charge is not borne by Boone's ratepayers.

Boone states that the \$2.13 charge was determined in 1997 and 1998 and did not reflect the termination payment to NKWD or the 130 percent debt service coverage requirement of BFWC's bonds. Boone further stated that, because BFWC's construction costs were higher than anticipated, there was an increase in the amount of bonds issued.<sup>17</sup>

In assessing the reasonableness of the \$2.65 wholesale rate, the Commission considered that the rate was established by BFWC's bond resolution to maintain adequate debt service coverage. Under traditional rate-making methodology BFWC could recover not only operation and maintenance expenses but also depreciation and amortization expenses. The coverage calculations for BFWC exclude both depreciation and amortization expenses.<sup>18</sup> The inclusion of these two expenses would significantly increase the wholesale rate charged by BFWC.

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<sup>17</sup> Boone's Response to Commission Staff's Interrogatories and Requests for Production of Documents dated February 7, 2003, Item 1.

<sup>18</sup> Application, Exhibit 7, Appendix A-2-1.

Additionally, the wholesale rate of \$2.65 covers the cost of financing \$43,645,000<sup>19</sup> that was primarily used by BFWC to construct approximately \$35,000,000<sup>20</sup> in plant facilities necessary to deliver wholesale water from CWW's delivery point to Boone and the city of Florence. According to Boone, continued service from NKWD would require the construction of a new water treatment facility.<sup>21</sup> In 1997 the estimated costs to NKWD for constructing the necessary facilities was \$112 million.<sup>22</sup> In addition, Boone would have to invest an estimated \$10,628,000 in distribution main improvements to tie into the new NKWD facility.<sup>23</sup>

The current rate paid to NKWD by Boone of \$1.44 per 1,000 gallons appears to be insufficient to cover the costs of the facilities that would be required for NKWD to continue providing service to Boone. NKWD currently has pending before this Commission a rate proceeding in which it requests a wholesale rate of \$1.87 per cubic foot<sup>24</sup> or \$2.50<sup>25</sup> per 1,000 gallons to be charged to each wholesale customer. The requested rate does not reflect the cost of constructing a new water treatment facility.

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<sup>19</sup> Id., Appendix A-2-3.

<sup>20</sup> Id., Appendix A-2-2.

<sup>21</sup> Case No. 2000-00206, final Order dated November 9, 2002 at 13.

<sup>22</sup> Id. at 5.

<sup>23</sup> Id. at 14, Footnote 35.

<sup>24</sup> Case No. 2002-00105, Application of Northern Kentucky Water District for (A) an Adjustment of Rates; (B) a Certificate of Public Convenience and Necessity for Improvements to Water Facilities if Necessary; and (C) Issuance of Bonds, Exhibit N, Executive Summary, Schedule C.

<sup>25</sup> Cost per 100 cubic feet of \$1.87 / .75 = \$2.50 per 1,000 gallons.

The information reviewed by this Commission indicates that the \$2.65 per 1,000 gallons to be charged by BFWC is reasonable.

Having considered the evidence of record and being otherwise sufficiently advised, the Commission HEREBY ORDERS that:

1. The rates proposed by Boone in its application and included in Appendix B of this Order are approved for service rendered by Boone on and after the date Boone completes its connection to BFWC and disconnection from NKWD and Boone begins paying the wholesale rate of \$2.65 per 1,000 gallons.

2. Within 30 days subsequent to its connection to BFWC, Boone shall notify this Commission in writing and file its revised tariff setting out the rates approved herein.

3. Three years from the date of this Order, Boone shall file an income statement, along with any pro forma adjustments, in sufficient detail to demonstrate that the rates approved herein are sufficient to meet its operating expenses and annual debt service requirements.

Done at Frankfort, Kentucky, this 27<sup>th</sup> day of February, 2003.

By the Commission

ATTEST:

  
Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC  
SERVICE COMMISSION  
IN CASE NO. 2002-00295 DATED February 27, 2003

Year	As taken from Boone's Annual Reports				
	1997	1998	1999	2000	2001
Operating Revenue	\$ 4,331,169	\$ 4,452,582	\$ 5,217,705	\$ 5,302,833	\$ 5,659,811
Non Operating Revenue	161,455	251,497	245,012	337,195	318,069
Less: Operating Expenses	(3,999,272)	(4,112,546)	(4,663,666)	(4,913,405)	(5,346,970)
Income Available to Service Debt	<u>493,352</u>	<u>591,533</u>	<u>799,051</u>	<u>726,623</u>	<u>630,910</u>
Interest Expensed	162,678	261,210	272,283	273,787	265,120
Principal Paid	<u>145,000</u>	<u>150,000</u>	<u>160,000</u>	<u>165,000</u>	<u>175,000</u>
Total Debt Paid	<u>\$ 307,678</u>	<u>\$ 411,210</u>	<u>\$ 432,283</u>	<u>\$ 438,787</u>	<u>\$ 440,120</u>
Ratio of Income to Debt	<u>160%</u>	<u>144%</u>	<u>185%</u>	<u>166%</u>	<u>143%</u>
Amount of Revenue Over 125 percent Debt Coverage Ratio	<u>\$ 108,755</u>	<u>\$ 77,521</u>	<u>\$ 258,697</u>	<u>\$ 178,139</u>	<u>\$ 80,769</u>

Note: 1.25 Debt Service Requirement was established by 1992 General Bond Resolution. See Application, Exhibit 2, Page 231, The Application of Boone County Water District to Issue Revenue Bonds in a Principal amount not to Exceed \$2,840, Refunding and Discharging an Outstanding Revenue Bond Anticipation Note of the District Pursuant to the Provisions of KAR 5:001, Section 11.



## APPENDIX B

### APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2002-00295 DATED February 27, 2003

The following rates and charges are prescribed for the customers in the area served by Boone County Water District. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

#### Monthly Water Rates

##### Schedule A

First	3,000 gallons	\$15.45	Minimum Bill
Next	2,000 gallons	4.65	per 1,000 gallons
Next	5,000 gallons	4.40	per 1,000 gallons
Over	10,000 gallons	3.65	per 1,000 gallons

##### Schedule B

First	3,000 gallons	\$15.45	Minimum Bill
Next	2,000 gallons	5.15	per 1,000 gallons
Next	5,000 gallons	4.65	per 1,000 gallons
Next	140,000 gallons	4.40	per 1,000 gallons
Over	150,000 gallons	3.65	per 1,000 gallons

##### Minimum Charges

		Schedule A	Schedule B
5/8-3/4 Meter	3,000 gallons	\$15.45	\$15.45
1	5,000 gallons	24.75	25.75
1 ½	9,000 gallons	42.35	44.35
2	11,000 gallons	50.40	46.40
3	21,000 gallons	86.90	97.40
4	29,000 gallons	116.10	132.60
6 and Larger	100,000 gallons	375.23	445.00

##### Tank Wagon Sales:

All Usage	\$3.60 per 1,000 gallons
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