

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

NOTICE OF ADJUSTMENT OF)
THE RATES OF SPEARS WATER)
DISTRICT EFFECTIVE ON AND) CASE NO. 8375
AFTER NOVEMBER 16, 1981.)

O R D E R

On October 26, 1981, Spears Water District ("Spears") filed its notice seeking authority to increase its water service rates and charges by \$39,397 annually, a 21.09 percent increase, for total proposed annual revenues of \$226,177. Spears stated in its notice that the proposed increase was necessary to fulfill its obligations as a public utility, to maintain its service and ability to keep pace with its ever-increasing demands for service and to secure financing necessary to carry out the above-stated purposes. The Commission has granted Spears additional revenue of \$17,245 in this order.

In order to determine the reasonableness of the proposed increase the Commission held a public hearing on January 5, 1982. There were no intervenors in this proceeding.

All requested information has been filed, and the matter is now submitted for final decision by the Commission.

TEST PERIOD

For the purpose of testing the reasonableness of the proposed rates, the Commission has adopted the 12 months ending June 30, 1981, as the test period to be used in this matter.

REVENUES AND EXPENSES

Spears proposed various adjustments to its income statement to reflect more current operating conditions. The Commission is of the opinion that these adjustments are proper and has accepted them for rate-making purposes with the following exceptions:

Purchased Water

Throughout its history Spears has had substantial water losses, which in turn have drastically increased the amount of water Spears has purchased from its suppliers, the City of Nicholasville and Kentucky-American Water Company. In its previous proceeding before this Commission, Case No. 7657, Spears was denied a rate increase primarily because of the Commission's limitation of Spears' line loss of nearly 40 percent to 15 percent for rate-making purposes. Following the Commission's order denying its proposed rate increase, Spears undertook extensive efforts to reduce its line loss to more acceptable levels. As a result of these efforts, Spears discovered that the master meters through which water was purchased from its suppliers had been reading inaccurately. Following the correction in the registration of its master meters and in conjunction with

other efforts, Spears now estimates its line loss to be approximately 18.5 percent.⁽¹⁾ The pro forma level for its proposed purchased water expense was based on adjusted usage taking into consideration corrected meter readings.⁽²⁾ The Commission commends Spears for its efforts to reduce its substantial line loss. The Commission is of the opinion that while Spears' line loss has been substantially reduced its current level of 18.5 percent is excessive. We have thus limited Spears' purchased water expense to a 15 percent line loss, which reduces Spears' adjusted purchased water expense by \$9,124.⁽³⁾

Salary Expense

Spears requested a pro forma operation and maintenance salary expense of \$59,748; of this amount \$28,288 or 47 percent is to be paid to its general manager for services rendered. The Commission, following a review of its records for water districts (Appendix B), has determined that a reasonable salary for Spears' general manager is \$20,000, or a reduction of \$8,288.⁽⁴⁾

The Commission points out that it has allowed a generous salary for Spears' general manager, based on salaries of districts with an average number of customers four times that of Spears, and considering that many of the same duties are performed by other employees of Spears. The Commission does not look with favor on the payment by a utility, especially one with cash flow

(1) Notice Exhibit 6, Schedule 16, Pages 1, 2 and 3 of 3.

(2) Ibid.

(3) Exhibit 6, Schedule 16, water sold per books 81,030,760 gallons + 85% = 95,330,306 gallons.
Total price of purchased water during test period of 73,008.55 + total water purchased of 129,839,808 gallons equals \$0.00056 per gallon X 95,330,306 gallons = \$53,385.

(4) (Average salary for 1980) \$17,478 + 247 (Average 1980 CPI-W Index) X 282.5 (January 1982 CPI-W Index) = \$19,990.

difficulties, of salaries to its officers or employees which can only be termed extravagant and which only serve to place even greater pressure on the utility's ability to meet its cash operating requirements.

Depreciation Expense

Spears proposed a pro forma depreciation expense of \$19,263.⁽⁵⁾ The Commission has determined that this amount includes depreciation on \$112,399⁽⁶⁾ of contributed property. It is the policy of the Commission to compute depreciation expense on the basis of the original cost of the plant, less contributions in aid of construction, as ratepayers should not be required to provide recovery on that portion of the plant that has been provided at zero cost. Therefore, Spears' pro forma depreciation expense has been reduced by \$3,597.⁽⁷⁾

FICA and Unemployment Taxes

Spears' pro forma FICA and unemployment taxes of \$3,812 and \$1,020, respectively, were based on the pro forma salary expense proposed by Spears. These expenses have been reduced by \$364 and \$145 to reflect the above adjustment to operation and maintenance salaries.⁽⁸⁾

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- (5) Notice Exhibit 6, Schedule 11.
 - (6) Notice Exhibit 2, Schedule 2, Page 2 of 2.
 - (7) Contributed property of \$112,399 X cumulative depreciation rate of 3.2% = \$3,597.
 - (8) Operation and maintenance salaries allowed of \$50,460 X FICA tax rate of 6.7% = \$3,380; and X unemployment tax rate of 1.7% = \$858.
Notice Exhibit 6, Schedules 14 and 15.

Miscellaneous General Expenses

Spears included in its pro forma miscellaneous general expense legal fees in the amount of \$4,256 for services provided to Spears beyond the scope of those covered by retainer. Of this amount, Spears provided justification for only \$3,525. Therefore, the Commission has eliminated the unsubstantiated portion of \$731 for rate-making purposes.

Of the \$3,525 legal fees, \$1,170 was for research and investigation of a dispute with one of Spears' customers concerning the liability for connection fees. Spears included \$1,245 for legal fees in a dispute over territorial boundaries before the Jessamine County Court. Both of these expenses have been allowed. The Commission is of the opinion that as these expenses are nonrecurring, they should be amortized over a 3-year period, and has, therefore, further reduced the allowance for miscellaneous general expenses by \$1,610.

Moreover, Spears included \$910 for conferences with new customers concerning a potential application for a certificate of convenience and necessity. The Commission has excluded this expense as it pertains to a future proceeding and should be considered therein.

Spears increased its allowance for outside services by \$361 without providing justification for the increase and, therefore, the Commission has disallowed this expense. Spears, moreover, included \$1,200 in unbilled accounting fees in connection with Case No. 7657. The Commission is of the opinion that this

expense should be amortized over a 3-year period and has therefore reduced the miscellaneous expense allowance by an additional \$800, for a total reduction to miscellaneous expenses of \$4,412.

Following the above adjustments, Spears' operating revenues and expenses are as follows:

	<u>Spears Pro Forma</u>	<u>Commission Adjustments</u>	<u>Commission Adjusted</u>
Operating Revenues	\$ 192,420	\$ -0-	\$ 192,420
Operating Expenses	<u>199,123</u>	<u>(25,930)</u>	<u>173,193</u>
Operating Income (Loss)	<u>\$ (6,703)</u>	<u>\$ 25,930</u>	<u>\$ 19,227</u>

REVENUE REQUIREMENTS

Spears proposed a test period debt service of \$41,180, consisting of principal on long-term debt of \$9,000 with a corresponding interest requirement of \$21,393 and principal on short-term debt of \$25,000 amortized over a 3-year period with an interest requirement of \$2,453.⁽⁹⁾ The short-term debt consists of \$15,000 payable to the First National Bank of Nicholasville at 18 percent interest and \$10,000 payable to Spears Water Company at 17 percent interest. This short-term debt was incurred by Spears to enable it to meet its bond requirements and operating expenses.⁽¹⁰⁾ Since the short-term debt was incurred because of a lack of funds which is corrected in this order, it should not

(9) Notice Exhibit 6, Schedules 20 and 21.

(10) Transcript of Evidence, p. 52.

under normal circumstances be necessary for Spears to incur short-term debt in the future. Therefore, the short-term debt requirements have been disallowed for rate-making purposes, which reduces the allowable debt service to \$30,393.

The Commission is of the opinion that Spears' adjusted operating income which produces an adjusted debt service coverage of approximately .67X is unjust, unfair and unreasonable. The Commission is further of the opinion that a fair, just and reasonable debt service coverage is 1.2X in that this coverage will provide revenues sufficient to service its debt, provide for its bond ordinance fund requirements and provide a reasonable surplus for equity growth.

To achieve the debt service coverage found fair, just and reasonable the Commission has determined that Spears is entitled to increase its rates and charges to produce an increase in annual revenues of \$17,245, calculated as follows:

		(11)
	1.2X Debt Service Coverage	\$ 36,472
Add:	Adjusted Operating Expenses	173,193
	Subtotal	<u>\$209,665</u>
Less:	Adjusted Operating Revenue	<u>192,420</u>
	Increase in Gross Revenues	<u>\$ 17,245</u>

RATE DESIGN

In its application, Spears proposed to redesign its residential rate schedule. Spears' present residential schedule consists of a minimum bill and two declining rate steps. The

(11) Debt Service of \$30,393 X 1.2 = \$36,472.

proposed residential schedule consists of a minimum bill and one rate step. Both the present and the proposed residential schedules include a minimum bill usage allowance. The Commission is of the opinion that the redesign should be authorized, primarily on the basis of structural simplicity. Furthermore, the elimination of consumption-oriented declining rate steps should promote conservation and, consequently, attenuate the need for facility construction in the future.

In addition to the residential schedule redesign, Spears proposed to increase the minimum bill for residential service. However, Spears did not propose to increase the minimum bill for farm and mobile home service. Spears presented no evidence to support exempting farm and mobile home service from a minimum bill increase, and the Commission finds such an exemption unreasonable. The Commission is of the opinion that an overall revenue requirement increase should be distributed among all customer classifications and at each rate level within a customer classification. Therefore, the Commission has authorized an increase in minimum bill rates for residential as well as farm and mobile home service. Also, the Commission has established the consumption rate step at a uniform level.

In designing Spears' water rates, the Commission has analyzed water sales, consumption patterns, and customer distribution as the basis for determining the allocation of revenue requirement among customer classifications and the specific rates

authorized for each customer classification. The Commission is of the opinion and finds that the rates in Appendix A are the fair, just and reasonable rates to be charged by Spears, effective on and after the date of this order.

SUMMARY

The Commission, having considered the evidence of record and being advised, is of the opinion and finds that:

1) The rates and charges in Appendix A will produce gross annual operating revenues of \$204,025 and are the fair, just and reasonable rates to be charged in that they will allow Spears to pay its operating expenses, service its debt and provide a reasonable amount of surplus for equity growth.

2) The rates and charges proposed by Spears would produce revenues in excess of those found fair, just and reasonable by the Commission and should be denied upon application of KRS 278.030.

IT IS THEREFORE ORDERED that the rates and charges proposed by Spears be and they hereby are denied upon application of KRS 278.030.

IT IS FURTHER ORDERED that the rates and charges in Appendix A be and they hereby are approved as the fair, just and reasonable rates to be charged by Spears for service rendered on and after the date of this order.

IT IS FURTHER ORDERED that within 30 days of the date of this order, Spears shall file with this Commission its revised tariff sheets setting out the rates and charges approved herein.

Done at Frankfort, Kentucky, this 29th day of March, 1982.

PUBLIC SERVICE COMMISSION

Marlin M. Votz
Chairman

Katharine Randall
Vice Chairman

Don Carver
Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE COMMISSION OF KENTUCKY IN CASE NO. 8375 DATED March 29, 1982

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

Residential Service

The following rates are available for general residential service.

<u>Consumption</u>	<u>Monthly Rate</u>
First 2,000 gallons	\$ 7.80 (Minimum Bill)
Over 2,000 gallons	1.80 per 1,000 gallons

Mobile Home Service

The following rates are available for mobile home service where two or more mobile homes are served from a master meter.

<u>Consumption</u>	<u>Monthly Rate</u>
First 1,000 gallons per mobile home	\$ 4.50 (Minimum Bill)
Over 1,000 gallons per mobile home	1.80 per 1,000 gallons

Farm Service

The following rates are available for farm livestock and agricultural use and, in addition, require a residential service connection.

<u>Consumption</u>	<u>Monthly Rate</u>
First 1,000 gallons	\$ 3.90 (Minimum Bill)
Over 1,000 gallons	1.80 per 1,000 gallons

Meter Connections

Size

Nonrecurring Rate

5/8" X 3/4" Meter

\$ 250.00

1" Meter

375.00

APPENDIX B

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE COMMISSION
IN CASE NUMBER 8375, DATED March 29, 1982

This is a summary of the managerial salaries paid by the water districts used by this Commission in determining a reasonable managerial salary in this proceeding. These figures were taken from the 1980 annual reports.

<u>Water Districts</u>	<u>Number of Customers</u>	<u>Managerial Salary</u>
Boone County W.D.	3,559	\$ 13,333
Campbell County W.D.	12,742	28,992
Edmondson W.D.	1,940	13,499
Estill County W.D.	1,000	27,904
Hardin County W.D. #1	3,896	25,345
Hardin County W.D. #2	4,646	26,000
Henderson County W.D.	2,870	19,378
Henry County W.D.	1,784	19,000
Kenton County W.D.	28,679	30,000
Martin County W.D. #1	973	27,231
North Nelson W.D.	1,069	5,000
McCreary County W.D.	2,725	14,957
Muhlenburg County W.D.	2,992	14,430
Muhlenburg County W.D. #3	1,065	16,667
Ohio County W.D.	1,961	15,925

<u>Water Districts (Cont'd)</u>	<u>Number of Customers</u>	<u>Managerial Salary</u>
Sandy Valley W.D.	1,200	\$ 2,400
Southeast Daviess County W.D.	2,524	15,250
Union County W.D.	906	10,800
Waco W.D.	1,190	10,800
West Daviess County W.D.	<u>1,684</u>	<u>15,650</u>
 Total	 96,865	 \$ 349,561
Average	4,843	17,478