

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

PURCHASED WATER ADJUSTMENT FILING )  
OF THE FARMDALE WATER DISTRICT ) CASE NO. 7465-1

O R D E R

On June 28, 1984, Farmdale Water District ("Farmdale") filed its application with the Commission requesting approval of its purchased water adjustment ("PWA") clause and authority to adjust its rates in accordance with that clause. Farmdale proposed to recover the increase of \$78,773 in purchased water expense from its wholesale supplier, the Frankfort Electric and Water Plant Board ("Frankfort"), scheduled to become effective July 31, 1984. The Commission has accepted this proposal subject to the consideration of the absorption test described herein.

COMMENTARY

Prior to approving increased rates resulting from purchased water cost increases pursuant to 807 KAR 5:067, the Commission must examine a utility's financial condition to determine whether it can absorb any of the increased cost. If there is potential for absorption, the Commission may adjust rates to offset only that portion of the increased water cost which cannot be absorbed.

TEST PERIOD

Farmdale submitted comparative balance sheets and statements of revenues and expenses for calendar years 1982 and 1983.

Farmdale also filed statements of water purchased and water sold for the 12-month period ended May 31, 1984.

For calendar years 1982 and 1983, Farmdale had the following operating results:

	<u>1982</u>	<u>1983</u>
Operating Revenues	\$219,812	\$226,992
Operating Expenses	<u>196,610</u>	<u>201,043</u>
Operating Income	\$ 23,202	\$ 25,949
Other Revenues	40,493	40,072
Other Deductions	<u>24,347</u>	<u>24,178</u>
Net Income	<u>\$ 39,348</u>	<u>\$ 41,843</u>

As can be seen the two periods were very comparable and reflected few significant differences.

In accordance with the PWA regulation the Commission required Farmdale to update its statement of revenues and expenses to correspond to the 12-month period for which the statements of water purchased and water sold were filed. With such an update all revenues and expenses would be matched for a common 12-month period.

The results of the updated statement of revenues and expenses are as follows:

Operating Revenues	\$232,936
Operating Expenses	<u>244,488</u>
Operating Income	\$ <11,552 >
Other Revenues	39,840
Other Deductions	<u>24,192</u>
Net Income	<u>\$ 4,096</u>

An analysis of the updated data shows that Farmdale's operating expenses, aside from purchased water expense, increased

by 32 percent over the level incurred during calendar year 1983.<sup>1</sup> Normally, the recognition of major changes such as this is beyond the scope of a PWA proceeding. However, in this instance, the Commission is of the opinion that the 12-month period ended May 31, 1984, is the only accurate period available in terms of water sales volumes. The billing analysis and supplemental schedule of water sales reflect a major decrease in sales volumes from the amounts reported in the 2 preceding calendar years, but a higher level of revenues. While not absolutely precise, the revenues supported by the billing analysis are relatively accurate, thereby causing the Commission to conclude that the sales volumes reported in the 2 preceding calendar years were overstated, and that modifications and corrections are required for Farmdale's 1982 and 1983 annual reports on file with the Commission. Farmdale will be allowed approximately 90 days or until it files its 1984 annual report to submit the necessary corrections.

The Commission is concerned with the increase in Farmdale's operating expenses and it intends to monitor these costs through the review and audit of Farmdale's 1984 annual report. After its review, the Commission may reopen this docket or initiate a show-cause proceeding to determine if Farmdale's rates are fair, just and reasonable.

#### REVENUES AND EXPENSES

Farmdale did not propose any adjustments, as such, to its test year statement of operations. In compliance with the Commis-

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<sup>1</sup>  $(\$165,035 - \$125,342) \div \$125,342 = 31.7$  percent.

sion's regulation Farmdale included a calculation of the increase in purchased water costs for a 12-month period ending within 90 days of the effective date of Frankfort's rate increase. The Commission, after careful examination of Farmdale's financial condition, has made the following adjustments to Farmdale's test-year operating statement in accordance with its established rate-making policies:

Purchased Water Expense

Farmdale's purchased water expense for the test year was \$79,454. Based on adjusted test year sales of 150,869,600 gallons, and the Commission's standard limitation of a 15 percent water loss, Farmdale's normalized purchased water expense including the increase from Frankfort effective July 31, 1984, is \$141,995. Accordingly, the Commission has increased Farmdale's test period expenses by \$62,541 to reflect the increased purchased water expense.

Depreciation Expense

Farmdale's test-year depreciation expense was \$49,454. This reflects depreciation on total plant in service with a resulting composite rate of 3.0 percent. It is the policy of the Commission to compute depreciation expense for rate-making purposes on non-contributed plant only. Such a policy insures that ratepayers pay only for the plant in which the utility has made an investment and not the plant which the utility has acquired through contributions.

Farmdale's balance sheet reflects contributions in aid of construction of \$587,996 which represents 40.4 percent of the total cost of utility plant in service. In determining the pro forma depreciation expense the Commission has utilized Farmdale's composite depreciation rate and excluded contributed property, which results in the exclusion of 40.4 percent of the test-year depreciation expense. The adjusted depreciation expense for rate-making purposes is \$29,475, which reflects a reduction of \$19,979.

Adjustments to the test period operations produced the following results:

	<u>Actual</u>	<u>Commission Adjustments</u>	<u>Commission Adjusted</u>
Operating Revenues	\$232,936	\$ -0-	\$232,936
Operating Expenses	244,488	42,562	287,050
Operating Income	\$<11,552>	\$<42,562>	\$<54,114>
Other Income	39,840	-0-	39,840
Other Deductions	24,192	-0-	24,192
Net Income	<u>\$ 4,096</u>	<u>\$&lt;42,562&gt;</u>	<u>\$&lt;38,466&gt;</u>

#### REVENUE REQUIREMENTS

Farmdale's average annual debt service for the next 5 years is \$30,510. The Commission is of the opinion that a debt-service coverage of 1.2X is a fair, just and reasonable coverage for Farmdale to maintain in that it meets the requirements of its lenders and provides an adequate surplus for equity growth. Based on adjusted test period operations, the Commission finds that Farmdale should increase its rates to produce additional annual revenues as follows:

Adjusted Operating Expenses	\$287,050
1.2X Debt-Service Coverage	<u>36,612</u>
Revenue Requirement	\$323,662
Less:	
Adjusted Operating Revenue	232,936
Adjusted Other Income	<u>39,840</u>
Increase Granted	<u>\$ 50,886</u>

Thus, the Commission is of the opinion that Farmdale can and should absorb \$27,887 of the \$78,773 increase in its purchased water cost.

SUMMARY

The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that:

1. The purchased water adjustment clause proposed by Farmdale is in compliance with 807 KAR 5:067 and should be approved.

2. Farmdale has the potential to absorb \$27,887 of the total purchased water cost increase of \$78,773.

3. The rates as proposed by Farmdale are unfair, unjust and unreasonable and should be denied upon application of KRS 278.030.

4. A purchased water adjustment in the amount of \$.34 per 1,000 gallons and the rates in Appendix A will provide the additional revenues granted herein and are fair, just and reasonable, and therefore, should be approved.

5. The base rate for future application of the purchased water adjustment clause of Farmdale should be:

<u>Supplier</u>	<u>Rate</u>
Frankfort Electric and Water Plant Board	\$ .80 per 1,000 gallons

6. Farmdale's 1982 and 1983 annual reports reflect overstated sales volumes and should be amended to correct such overstatements.

IT IS THEREFORE ORDERED that the purchased water adjustment clause proposed by Farmdale be and it hereby is approved effective on and after the date of this Order.

IT IS FURTHER ORDERED that the rates proposed by Farmdale be and they hereby are denied.

IT IS FURTHER ORDERED that the rates in Appendix A are the fair, just and reasonable rates to be charged for water service rendered on and after the date of this Order and are hereby approved.

IT IS FURTHER ORDERED that for the purpose of future application of the purchased water adjustment clause of Farmdale the base rate for purchased water shall be:

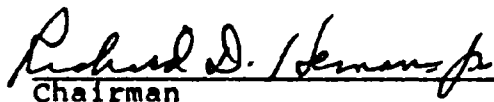
<u>Supplier</u>	<u>Rate</u>
Frankfort Electric and Water Plant Board	\$ .80 per 1,000 gallons

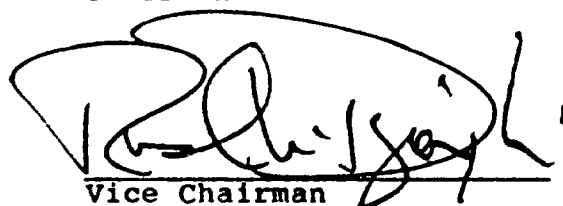
IT IS FURTHER ORDERED that Farmdale shall file with the Commission within 30 days of the date of this Order its revised tariff sheets setting out the purchased water adjustment clause and the rates approved herein.

IT IS FURTHER ORDERED that within 90 days of the date of this Order, or by no later than the date its 1984 annual report is filed, Farmdale should amend its 1982 and 1983 annual reports to comply with Finding No. 6 of this Order.

Done at Frankfort, Kentucky, this 3rd day of January, 1985.

PUBLIC SERVICE COMMISSION

  
Chairman

  
Vice Chairman

  
Commissioner

ATTEST:

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Secretary



APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE  
COMMISSION IN CASE NO. 7465-1 DATED 1/3/85

The following rates are prescribed for customers of Farmdale 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.

DOMESTIC 5/8-inch x 3/4-inch Meter

<u>Usage Block</u>	<u>Rate</u>
First 2,000 gallons	\$ 6.68 Minimum
Next 3,000 gallons	1.84 per 1,000 gallons
Next 5,000 gallons	1.34 per 1,000 gallons
Over 10,000 gallons	1.14 per 1,000 gallons

DOMESTIC 1-inch Meter, Industrial and Commercial

<u>Usage Block</u>	<u>Rate</u>
First 7,000 gallons	\$14.88 Minimum
Next 3,000 gallons	1.34 per 1,000 gallons
Next 140,000 gallons	1.14 per 1,000 gallons
Over 150,000 gallons	.89 per 1,000 gallons