

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF THE WESTERN)
ROCKCASTLE WATER ASSOCIATION, INC.,)
FOR (1) A CERTIFICATE OF PUBLIC CON-)
VENIENCE AND NECESSITY, AUTHORIZING)
AND PERMITTING SAID WATER ASSOCIATION)
TO CONSTRUCT A WATERWORKS DISTRIBUTION)
SYSTEM, CONSISTING OF EXTENSIONS,)
ADDITIONS AND IMPROVEMENTS TO THE) CASE NO. 9145
EXISTING WATER DISTRIBUTION SYSTEM;)
(2) APPROVAL OF THE PROPOSED PLAN OF)
FINANCING OF SAID PROJECT; AND (3))
APPROVAL OF THE WATER RATES PROPOSED)
TO BE CHARGED BY THE ASSOCIATION TO)
ITS CUSTOMERS)

O R D E R

The Western Rockcastle Water Association, Inc., ("Western Rockcastle") filed its application on September 25, 1984, for approval of adjustments to its water service rates, authorization to construct a \$1,004,000 waterworks improvement project and approval of its plan of financing for this project. The planned financing includes a \$632,500 grant from the Farmers Home Administration ("FmHA"), an FmHA loan of \$319,000, and a local contribution of \$52,500 from applicants for service in the project area. The FmHA loan will be secured by waterworks revenue bonds maturing over a 40-year period at an interest rate of 7 1/8 percent per annum.

The proposed construction will provide service to 231 additional customers in Rockcastle, Lincoln, and Pulaski counties. Drawings and specifications for the proposed improvements as prepared by Kennoy Engineers, Inc., of Lexington, Kentucky, ("Engineer") have been approved by the Division of Water of the Natural Resources and Environmental Protection Cabinet.

A hearing on Western Rockcastle's proposed construction, financing and rates was held in Frankfort, Kentucky, on April 23, 1985. There were no intervenors and no protests were entered.

The rates proposed by Western Rockcastle would produce additional annual revenues of \$57,078, an increase of 37.4 percent over test-period revenues. Based on the determination herein, the revenues of Western Rockcastle will increase by \$49,137 annually, an increase of 32.2 percent over test-period revenues.

COMMENTARY

Western Rockcastle is a non-profit water utility engaged in the distribution and sale of water to approximately 720 customers in Rockcastle, Lincoln, and Pulaski counties, Kentucky.

TEST PERIOD

Western Rockcastle proposed and the Commission has accepted the 12-month period ending July 31, 1984, as the test period in this matter. In utilizing the historical test period, the Commission has given full consideration to known and measurable changes found reasonable.

REVENUES AND EXPENSES

Western Rockcastle proposed several adjustments to revenues and expenses in its original application. Western Rockcastle's

proposed adjustments include the effect that the new customers will have upon the revenues and expenses of the district. The Commission is of the opinion that the proposed adjustments are generally proper and acceptable for rate-making purposes with the following modifications:

Purchased Water Expense

Western Rockcastle reported test-period purchased water expense of \$44,977. This expense was based on total gallons purchased of 53,544,050 which reflected a 27.4 percent water loss. Western Rockcastle provided no justification for why its water loss should exceed the Commission's maximum allowable level of 15 percent. Therefore, based on sales of 38,846,390 gallons and the Commission's normal practice of limiting water loss to 15 percent for rate-making purposes, Western Rockcastle's allowable test-period purchased water expense amounts to \$38,389.

Western Rockcastle proposed an adjustment of \$9,187 to test-period purchased water expense based on 210 additional residential customers. At the hearing held at the Commission's offices on April 23, 1985, Western Rockcastle stated that it will be serving 231 additional customers rather than 210. Based on the test-period average usage for residential customers of 4,011 gallons per month and an allowance of 15 percent water loss, the Commission has determined that the adjustment to Western Rockcastle's allowable test-period purchased water expense should be \$10,988. Therefore, the Commission has allowed, for rate-making purposes, a total purchased water expense of \$49,377.

Pumping Expense

Western Rockcastle proposed an adjustment of \$1,500 to pumping expense. In response to Item No. 13 of the Commission's Information Order of November 29, 1984, Western Rockcastle stated only that the amount of the adjustment was estimated based on the additional water to be utilized by the proposed customers over the amount used by the existing customers. The basis of the estimate was not provided. The Commission does not allow adjustments based on estimates, but rather only allows adjustments that are known and measurable. Therefore, the Commission has allowed the test-period actual pumping expense of \$3,455 for rate-making purposes herein.

Outside Services Employed

Western Rockcastle reported test-period charges of \$3,892 to Account No. 923--Outside Services Employed. In response to Item No. 11 of the Commission's Information Order of November 29, 1984, Western Rockcastle provided a breakdown of the test-period charges to that account, but did not supply detailed information on the actual services provided. According to the breakdown, Western Rockcastle was billed \$117 for services rendered by its attorney, Mr. Jerry J. Cox, during the test period. Besides the \$117 paid to Mr. Cox, Western Rockcastle paid an additional \$1,875 to retain the services of Mr. Cox during the test period. The retainer was \$150 per month for the first 9 months of the test period and \$175 per month for the last 3 months of the test period.

In its Information Order of November 29, 1984, the Commission requested Western Rockcastle to provide a description of the services rendered in each transaction. Western Rockcastle did not comply with this request. The Commission is of the opinion that a utility the size of Western Rockcastle does not require the retention of the services of an attorney on an ongoing basis and that a reasonable approach would be for the utility to obtain the services of an attorney on an as-needed basis. The Commission is of the opinion that the ratepayers of Western Rockcastle should not bear the cost of management's decision to retain the services of an attorney on an ongoing basis when no evidence has been provided that these services are needed. Therefore, the Commission has excluded \$1,875 for rate-making purposes, the cost to retain the services of Western Rockcastle's attorney for the test period. This adjustment results in adjusted outside services expenses of \$2,017.

Depreciation Expense

Western Rockcastle reported test-period depreciation expense of \$27,229. A portion of the gross utility plant in service is contributed property. It is the Commission's practice to disallow depreciation on contributed property for rate-making purposes since ratepayers should not be required to pay for depreciation of plant funded with contributed capital.

According to the balance sheet submitted with its application, gross utility plant in service at the end of the test period amounted to \$1,328,277. During the test period, Western Rockcastle incurred an expense of \$22,423 to relocate water lines

due to highway construction. The State Highway Department reimbursed Western Rockcastle for the entire cost of the project. Therefore, Western Rockcastle should have capitalized the cost of the project, adding \$22,423 to gross plant in service, and increased contributions in aid of construction by the same amount. The resulting ratio of non-contributed plant in service is 36.6 percent.

Applying the test year actual depreciation rate of 2.05¹ percent to the adjusted total plant in service of \$1,350,700 results in total annual depreciation expense of \$27,689. Therefore, allowable depreciation expense for rate-making purposes is \$10,144 or 36.6 percent of the adjusted depreciation expense.

Western Rockcastle also proposed to adjust depreciation expense to reflect depreciation on the portion of the proposed new construction to be financed by loan funds, at a rate of 2 percent. The Commission concurs with this approach inasmuch as it excludes depreciation on contributed property and has therefore allowed, for rate-making purposes, depreciation expense on new construction of \$6,380.²

After consideration of the above adjustments the Commission has allowed, for rate-making purposes herein, total depreciation expense of \$16,524.³

¹ $\$27,229 + \$1,328,277 \times 2.0499\%$.

² $\$319,000 \times 2\% = \$6,380$

³ $\$10,144 + 6,380 = \$16,524.$

Other Income

Western Rockcastle reported test-period rental income of \$3,660. Western Rockcastle leases an office building which contains office space for the utility, commercial space occupied by a barber shop, and five apartments. Western Rockcastle contends that it could find no other building suitable for its operations. Mr. Jerry Cox, the attorney retained by Western Rockcastle during the test period, is one of the owners of the building.

In its application filed September 25, 1984, Western Rockcastle proposed an adjustment of \$2,220 to increase test-period rental income. In Item Number 21 of its Information Order of November 29, 1984, the Commission asked Western Rockcastle for the source of test-period rental income of \$3,660 and to provide a description of any expenses associated with the generation of the rental income. In response, Western Rockcastle stated that monthly rental income was \$490 at the time the application was filed on September 25, 1984, but that subsequently two additional apartments had been constructed. No response was offered on the matter of expenses associated with generation of the rental income. In response to a request at the hearing held at the Commission's offices on April 23, 1985, Western Rockcastle submitted a statement of current rental income which shows a monthly total of \$860. At that rate, Western Rockcastle would realize rental income of \$10,320 on an annual basis. Western Rockcastle proposed an adjustment to increase test-period rent expense by \$5,050 annually. Allowance of this adjustment along with an annual increase of

only \$2,220 in rental income would produce a substantial increase in net annual rental expense. However, considering the annual increase in rental income of \$6,660,⁴ which is the current level of rental income, Western Rockcastle will realize a net gain on the rental of its office space. Therefore, the Commission has set, for rate-making purposes, Western Rockcastle's annual rental income at \$10,320.

The Commission condones this rental arrangement to the extent that the revenues and expenses associated with this transaction result in income to the utility. In future proceedings, Western Rockcastle should be able to provide a complete accounting for the revenues and expenses associated with this transaction. Such expenses should be included in Account Number 426--Miscellaneous Income Deductions.

After consideration of the aforementioned adjustments, the Commission finds Western Rockcastle's test-period operations to be as follows:

	<u>Actual Test Period</u>	<u>Pro Forma Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$ 152,731	\$ -0-	\$ 152,731
Operating Expense	146,222	1,661	147,883
Net Operating Income	<u>\$ 6,509</u>	<u>\$ < 1,661 ></u>	<u>\$ 4,848</u>
Other Income	10,113	7,160	17,273
Other Expense	27,677	22,729	50,406
Net Income	<u><u>\$ < 11,055 ></u></u>	<u><u>\$ < 17,230 ></u></u>	<u><u>\$ < 28,285 ></u></u>

⁴ \$10,320 - \$3,660 = \$6,660.

REVENUE REQUIREMENTS

The Commission is of the opinion that the adjusted test-period operating loss is clearly unjust and unreasonable. The Commission finds the debt-service coverage method to be a fair, just and reasonable method of determining revenue requirements in this case and adequate to allow Western Rockcastle to pay its operating expenses, meet its debt-service requirements and maintain a reasonable surplus. The Commission finds Western Rockcastle's revenue requirement to be \$219,141⁵ based upon a 1.2X debt-service coverage which would require an increase in annual revenue of \$49,137 from sales of water.

CONTINUITY OF ADEQUATE AND RELIABLE SERVICE

Western Rockcastle's Engineer has provided information and testimony which appear to indicate that reliable and adequate service can be maintained throughout the expanded system after completion of the proposed construction. The Commission is concerned, however, that Western Rockcastle's service to its customers may not be totally adequate in the long term, due to the constraints of its existing water distribution system and the "marginal" size of various components.

The Commission reminds Western Rockcastle of its obligation to provide adequate and reliable service to all of its customers.

⁵ Staff-Adjusted Test-Period Operating Expense	\$ 147,883
Add: 5-Year Average of Principal and Interest Requirements	59,382
Add: .2 Coverage Factor	<u>11,876</u>
Total Revenue Requirement	\$ <u>219,141</u>

Western Rockcastle should monitor the adequacy of the expanded water distribution system after construction. If this monitoring indicates that the level of service is inadequate or declining, Western Rockcastle must take necessary action to maintain the level of service in conformance with the regulations of the Commission.

FINDINGS AND ORDERS

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

1. Public convenience and necessity require that the construction proposed in the application and record be performed and that a certificate of public convenience and necessity be granted.

2. The approved construction includes about 33 miles of water mains, a 44,000-gallon water storage tank, and miscellaneous appurtenances thereto. The low bids received for the proposed work totaled \$748,123, which will require about \$1,004,000 after allowances are made for fees, contingencies and other indirect costs.

3. Any deviations from the approved construction which could adversely affect service to any customer should be subject to prior approval of this Commission.

4. The financing proposed by Western Rockcastle for this project will be needed to pay for the work herein approved. Western Rockcastle's financing plan should, therefore, be approved.

5. Western Rockcastle should file with the Commission duly verified documentation which shows the total costs of construction including all capitalized costs (engineering, legal, administrative, etc.) within 60 days of the date that construction is substantially completed. Said construction costs should be classified into appropriate plant accounts in accordance with the Uniform System of Accounts for Water Utilities prescribed by this Commission.

6. Western Rockcastle's contract with its Engineer should require the provision of construction inspection under the general supervision of a professional engineer with a Kentucky registration in civil or mechanical engineering. The supervision and inspection should insure that the construction work is done in accordance with the contract drawings and specifications and in conformance with the best practices of the construction trades involved in the project.

7. Western Rockcastle should require the Engineer to furnish a copy of the record drawings and a signed statement that the construction has been satisfactorily completed in accordance with the contract drawings and specifications within 60 days of the date of substantial completion of this construction.

8. Western Rockcastle should file with the Commission a copy of all contractual agreements for the provision of services or the purchase of services which are subject to the approval of this Commission.

9. Western Rockcastle should take steps to correct its excessive test-period water loss and should supply to the Commission, within 60 days of the date of this Order, its plans to do so.

10. The rates in Appendix A are fair, just and reasonable rates for Western Rockcastle in that they will produce gross annual revenues from water sales of \$198,498. These revenues along with other operating revenues of \$3,370 and other income of \$17,273 will be sufficient to meet Western Rockcastle's operating expenses found reasonable for rate-making purposes, service its debt, and provide a reasonable surplus.

11. The rates proposed by Western Rockcastle would produce revenue in excess of that found reasonable herein and should be denied upon application of KRS 278.030.

IT IS THEREFORE ORDERED that Western Rockcastle be and it hereby is granted a certificate of public convenience and necessity to proceed with the waterworks improvements projects set forth in the drawings and specifications of record hereby approved.

IT IS FURTHER ORDERED that Western Rockcastle shall comply with all matters set out in Findings 3 through 9 as if the same were individually so ordered.

IT IS FURTHER ORDERED that the rates in Appendix A be and they hereby are approved for service rendered by Western Rockcastle on and after the date of this Order.


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

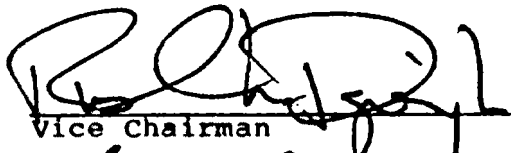
IT IS FURTHER ORDERED that within 30 days from the date of this Order Western Rockcastle shall file with this Commission its revised tariff sheets setting out the rates approved herein.

Nothing contained herein shall be deemed a warranty of the Commonwealth of Kentucky, or any agency thereof, of the financing herein authorized.

Done at Frankfort, Kentucky, this 12th day of July, 1985.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 9145 DATED July 12, 1985.

The following rates and charges are prescribed for the customers receiving water service from Western Rockcastle Water Association, Inc. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

USAGE BLOCKS

MONTHLY RATES

First 2,000 gallons	\$ 9.15 Minimum
Next 3,000 gallons	4.05 per 1,000 gallons
Next 5,000 gallons	3.05 per 1,000 gallons
Next 40,000 gallons	1.75 per 1,000 gallons
Over 50,000 gallons	1.50 per 1,000 gallons

MINIMUM BILLS*

	<u>Minimum Usage</u>	<u>Minimum Bill</u>
5/8 - inch meter	2,000 gallons	\$ 9.15
1 - inch meter	5,000 gallons	21.30
1 1/2 - inch meter	10,000 gallons	36.55
2 - inch meter	16,000 gallons	47.05

* Usage in excess of the minimum shall be billed according to the rate schedule.