

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF SOUTH SIDE )  
WATER ASSOCIATION FOR AN ADJUST- )  
MENT OF RATES PURSUANT TO THE ) CASE NO. 9152  
ALTERNATIVE RATE ADJUSTMENT FOR )  
SMALL UTILITIES )

O R D E R

On September 26, 1984, South Side Water Association ("South Side") filed an application with the Commission to increase its rates pursuant to 807 KAR 5:076, Alternative Rate Adjustment Procedure for Small Utilities ("ARF"). The proposed rates would produce additional revenue of approximately \$10,024 annually, an increase of 20 percent. Based on the determination herein, a deficiency of \$5,652 annually exists in the revenues of South Side and, therefore, an 11 percent increase in annual revenues has been granted in the total amount of \$5,652.

COMMENTARY

South Side is a non-profit water distribution system organized and existing under the laws of the Commonwealth of Kentucky and serves approximately 291 customers in Lee County, Kentucky.

TEST PERIOD

South Side proposed and the Commission has accepted the 12-month period ending December 31, 1983, as the test period for

determining the reasonableness of the proposed rates. In utilizing the historical test period, the Commission has given full consideration to known and measurable changes found reasonable.

#### REVENUES AND EXPENSES

The financial data contained in South Side's 1983 Annual Report have been used as the basis for determining revenue requirements. South Side proposed adjustments to revenue and expenses as reflected in the comparative income statement filed in Part II of its application. The Commission is of the opinion that the proposed adjustments are generally proper and acceptable for rate-making purposes with the following modifications to reflect actual and anticipated operating conditions:

#### Purchased Water

The reported annual cost of purchased water for the test period is \$22,597. South Side proposed to increase this amount by \$9,717 annually based on estimated price increases from its supplier.<sup>1</sup> The current price charged by its supplier is \$1.16 per 1,000 gallons of water.<sup>2</sup> Adjustments based upon expected or estimated price increases are speculative and, therefore, do not meet the known and measurable criteria required by this Commission for adjustments to the historical test period. Furthermore, the record as it stands submitted supports no intention on the part of South Side's supplier to raise its rate beyond that currently

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<sup>1</sup> Application, pp. 2-3, dated September 26, 1984.

<sup>2</sup> Response to No. 30 of Commission Request dated March 5, 1985.

being charged. Therefore, the Commission has disallowed the proposed adjustment of \$9,717.

South Side reported a 19 percent test-period water loss. South Side offered no reason for the Commission to exempt it from the policy of allowing a maximum 15 percent water loss for rate-making purposes. Therefore, the Commission determined the allowable volume of water purchased based on test-year sales divided by 85 percent and has reduced test-period purchased water costs by \$980 to reflect the maximum allowable water cost at \$1.16 per 1,000 gallons.

In response to a Commission request, South Side provided the test-period billings for purchased water from its supplier. Based on the current price and the test-period volumes, South Side overpaid its supplier \$482. The Commission deems this amount to be imprudently incurred and has reduced by \$482 the test-period purchased water costs.

The aggregate affect of all adjustments to purchased water is to reduce test-period purchased water costs by \$1,462 to \$21,135 annually.

#### Power for Pumping

South Side reported \$2,305 in test-period power for pumping expense. South Side proposed a \$500 annual increase in this amount based on historic price increases. Such estimated price adjustments do not meet known and measurable criteria necessary for rate-making purposes.

In response to a Commission request, South Side provided the test-period billings from its supplier.<sup>3</sup> The Commission usually accepts only those adjustments which are known and measurable; however, based on the actual test-period kilowatt hours used and the suppliers' current rates and current taxes, the Commission has increased power expense for pumping by \$825 to \$3,130 annually.

#### Operation Supplies and Expenses

South Side reported \$7,453 in test-period operation supplies and expenses. South Side proposed an additional \$4,000 annual adjustment to this expense based on an estimated historical increase above the prior year.<sup>4</sup> The Commission restates its viewpoint concerning adjustments based upon estimated price increases that they inherently do not meet known and measurable criteria and, therefore, disallows the \$4,000 proposed adjustment.

In response to a Commission request for invoices supporting expenditures of over \$50 to operation supplies and expenses, South Side provided invoices which indicated that \$2,608 was expended for transmission lines, \$572 was expended for service lines, and \$2,557 was expended for meter replacements.<sup>5</sup> When further asked

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<sup>3</sup> Response to No. 3 of Commission request dated December 17, 1984.

<sup>4</sup> Application, pp. 2-3, dated September 26, 1984.

<sup>5</sup> Response to No. 1 of Commission request dated December 17, 1984.

to provide evidence why these expenditures should not be capitalized and depreciated over appropriate useful lives, South Side provided no response. The Commission is of the opinion that expenditures for assets with useful lives of more than one period provide benefits longer than the single period when incurred, and should be capitalized and depreciated over the periods benefited. Therefore, the Commission has reduced the test-period operations and supplies expense of \$7,453 by the amount of \$5,737 in capital items improperly expensed to \$1,716 annually.

#### Other Supplies and Expenses

South Side reported \$1,157 in other supplies and expenses. South Side requested \$69 of additional monies annually based on the increase in postage rates and the need for an office calculator.<sup>6</sup> The Commission is of the opinion that the allowed depreciation provides sufficient internal funds to afford the purchase of an office calculator without providing additional revenue through rates. Therefore, the Commission has disallowed \$34 of this adjustment.

The Commission, however, does realize that the increase in postage rates represents an ongoing real cost of service and has increased test-period other supplies and expense by \$35 based on the number of customers at the end of the test period and the increase in postcard rates.

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<sup>6</sup> Application, pp. 2-3, dated September 26, 1985.

### Employee Pensions and Benefits

As a consequence of a wage and salary increase and also an increase in the FICA contribution rate from 6.7 percent to 7.0 percent, South Side proposed an adjustment of \$76 to employee pensions and benefits.<sup>7</sup> South Side reported \$252 in test-period FICA taxes at the 6.7 percent rate on approximately \$3,761 in FICA taxable wages.

In this case, South Side proposed and the Commission has accepted a \$500 annual increase in wages and salaries, as this is a 5.5 percent increase and is reasonable since it is not excessive compared to the rate of inflation of 4.6 percent (based on the Consumer Price Index as of the end of February 1985) that has occurred since South Side's last wage increase in 1983. Based on the amount of taxable wages and the \$500 increase in wages and salaries, the Commission has determined a reasonable amount of \$298 in annual FICA taxes. Thus the Commission has increased test-period employee pensions and benefits by \$46 annually.

### Depreciation Expense

South Side reported \$5,669 in annual depreciation expense. As noted elsewhere in this Order, the Commission has capitalized \$2,608 in transmission lines, \$572 in service lines, and \$2,557 in meter replacements. In recognition of these capitalized items, test-period depreciation expense has been increased in the amount of \$350 through depreciation of these assets over their useful

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<sup>7</sup> Application, pp. 2-3, dated September 26, 1985.

lives found reasonable by the Commission of 40, 20 and 10 years, respectively.

South Side also reported test-period contributions in aid of construction in the total amount of \$53,652. The Commission has taken the position in numerous rate Orders for water utilities that depreciation expense allowed for rate-making purposes represents a return of investment and as such South Side has not invested in utility plant in service to the extent of the \$53,652 in contributions in aid of construction which represents approximately 19 percent of utility plant in service. Therefore, the Commission has disallowed depreciation associated with contributions in aid of construction and has reduced depreciation expense by \$1,073 annually.

The aggregate effect of the Commission's adjustments is to reduce test-period depreciation expense by \$723 annually.

After consideration of the aforementioned adjustments, the Commission finds South Side's adjusted test-period operations are as follows:

	<u>Reported Test Period</u>	<u>Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$50,018	\$ -0-	\$50,018
Operating Expenses	<u>49,537</u>	<u>&lt;6,516&gt;</u>	<u>43,021</u>
Operating Income	\$ 481	\$ 6,516	\$ 6,697
Other Income	2,290	-0-	2,290
Interest Expense on Long-Term Debt	<u>9,123</u>	<u>-0-</u>	<u>9,123</u>
Net Income	<u>\$&lt;6,352&gt;</u>	<u>\$ 6,516</u>	<u>\$ 164</u>

### REVENUE REQUIREMENTS

South Side's debt service, based on the average principal and interest payments due within the next 5 years, is \$12,449 annually. The adjusted test-period operating statement reflects a net income of \$164 which provides inadequate coverage on South Side's debt service obligations. The Commission is of the opinion that the adjusted net income is inadequate and will adversely affect the financial condition of South Side. The Commission deems that a 1.2X debt service coverage is fair and reasonable, and to improve South Side's financial condition, additional revenues of \$5,562 will be required. Based on adjusted test-period results, total revenue of \$55,670 will produce net operating income of \$12,649 which, after considering other income of \$2,290, will be sufficient to allow South Side to pay its operating expenses and provide a 1.2X debt service coverage on its annual debt service obligations.

### SUMMARY

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

1. The rates in Appendix A are fair, just and reasonable rates for South Side in that they will produce annual operating revenues of approximately \$55,670 and should be approved. These revenues will be sufficient to meet South Side's operating expenses found reasonable for rate-making purposes, service its debt, and provide a reasonable surplus.
2. The rates proposed by South Side would produce revenue in excess of that found reasonable herein and should be denied.



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

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

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

Done at Frankfort, Kentucky, this 21st day of May, 1985.

PUBLIC SERVICE COMMISSION

  
Chairman

  
Vice Chairman

  
Commissioner

ATTEST:

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Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 9152 DATED May 21, 1985

The following rates and charges are prescribed for the customers receiving water service from South Side 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.

Rates: Monthly

First 2,000 gal	\$ 8.05 Minimum Bill
Next 4,000 gal	3.35 per 1000
Next 4,000 gal	2.60 per 1000
Next 15,000 gal	2.25 per 1000
Next 25,000 gal	2.05 per 1000
Over 50,000 gal	1.75 per 1000