

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

AN ADJUSTMENT OF RATES OF BIG)
SANDY WATER DISTRICT) CASE NO. 9156

O R D E R

On October 11, 1984, Big Sandy Water District ("Big Sandy") filed with the Commission an application requesting authority to increase its water rates. Big Sandy stated that the requested increase was necessary because of the additional expense relating to the cost of purchased water, debt service, and operating expenses. The proposed rates would produce additional operating revenues of approximately \$106,000 annually, an increase of 71 percent over normalized test-year operating revenues. Based upon the determination herein, Big Sandy's operating revenue will increase by \$60,448, an increase of 45.7 percent.

As part of its endeavor to shorten and simplify the regulatory process for small utilities such as Big Sandy, the Commission chose to perform a limited financial audit for the test year (calendar year 1983). The Commission's objective was to substantially reduce the need for written data requests, thus reducing the expense to Big Sandy. The staff audit report of Big Sandy's financial operations for the calendar year 1983 was filed

as a part of the record in this case as an appendix to the Commission's Order dated February 15, 1985.

A public hearing was conducted on April 4, 1985, at the Commission's offices in Frankfort, Kentucky. There were no intervenors in this proceeding.

COMMENTARY

Big Sandy is a non-profit water utility engaged in the distribution and sale of water to approximately 657 customers in Boyd and Carter Counties, Kentucky.

TEST PERIOD

Big Sandy 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.

REVENUES AND EXPENSES

For the test period, Big Sandy reported a net operating loss of \$35,755. Big Sandy proposed several pro forma adjustments to revenues and expenses to reflect more current and anticipated operating conditions.

Staff Audit Report Adjustments

In the course of its investigation in this case, the Commission staff performed a limited audit to verify reported test-year expenses and determine what accounting or classification changes might be appropriate. Based upon the findings contained in the Commission's Audit Report of Big Sandy dated February 15, 1985, the Commission has made the following adjustments to reported test-year operating expenses:

	1983 Actual Test Year <u>Per Annual Report</u>	<u>Adjustments</u>	<u>Test Year Per Staff Audit</u>
Operating Revenues	\$127,864	\$ -0-	\$ 127,864
Operating Expenses	148,084	<20,449>	127,635
Operating Income	\$<20,220>	\$ 20,449	\$ 229
Other Income	7,215	-0-	7,215
Interest on LTD	22,750	-0-	22,750
Net Income	<u>\$<35,755></u>	<u>\$ 20,449</u>	<u>\$ <15,306></u>

In its response to the audit report, Big Sandy stated that it believed that \$7,469 of outside services for services rendered prior to the test year should be included for rate-making purposes because "...at the end of any accounting period there will be a small amount of such expenses which flow into the next period." The Commission concurs with Big Sandy's contention and took this into consideration when determining the findings of the audit. However, in this instance the expenditures totaling \$7,469 were for services related to construction and were, therefore, required to be capitalized in accordance with the Uniform System of Accounts for Class C Water Utilities. Appropriate adjustments to depreciation expense have been made to reflect the capitalization of these expenditures.

The Commission has made additional adjustments to the test year as determined in the audit report, based on the following findings of fact to reflect more normal and current operating conditions:

Revenue Normalization

Big Sandy proposed an adjustment of \$15,231 to reflect the normalization of revenues to the customer level being served as of

May 31, 1984.¹ Since Big Sandy did not begin operations until late 1982 and did not attain its current customer level until May, 1983, the Commission has accepted this proposed adjustment.

Purchased Water

Big Sandy proposed an adjustment of \$39,951 to test-year purchased water expense. This adjustment was based on projected gallons purchased to provide for the normalized sales contained in the revenue adjustment based on customers included in the May 31, 1984, billing and a projected increase in the rate charged by Big Sandy's supplier, Kenova Water District ("Kenova"), to \$1.51 from \$.58. However, this rate increase had not gone into effect as of the date of the hearing.

The Commission has determined that the method proposed by Big Sandy is reasonable under the circumstances, since Big Sandy did not achieve its normal operating level until May, 1983. The Commission has, therefore, used this method for the purpose of determining revenue requirements herein; however, the Commission has modified Big Sandy's calculation to exclude purchased water expense associated with line loss in excess of 15 percent. 807 KAR 5:067, Section 2(2), Purchased Water Adjustment Clause, states, "In instances where the water loss exceeds fifteen (15) percent, the actual water sales shall be divided by eighty-five (85) percent yielding the maximum allowable water purchases." It has been the Commission's practice to extend this treatment to purchased water adjustments associated with general rate cases.

¹ Application, Schedule I, Adjustment 2.

Furthermore, Big Sandy's engineer testified at the hearing that line loss should be lowering to 15 percent or below in the future.² This lowering will be due primarily to more careful accounting of water usage by fire departments and for flushing of lines and correction of tank overflow and more accurate metering of purchases from Kenova.

The exclusion of the excess line loss results in adjusted sales of 39,001,847 gallons. The Commission priced the purchases at the new Kenova rate of \$1.51 per thousand gallons, resulting in a purchased water expense of \$58,902.

General Increase in Costs Adjustment

Big Sandy proposed to increase several expense accounts by 5 percent, resulting in an adjustment of \$3,479.³ The only explanation given by Big Sandy for these adjustments was its statement that, "A 5 percent general increase in cost has been assumed on all other costs not directly accounted for."

The Commission notified Big Sandy that it is the Commission's practice not to allow adjustments based upon inflation or estimates and requested that it provide any known and measurable changes to these accounts. In response to this request, Big Sandy filed a statement from Utility Pipe & Supply Corporation stating, "Please be advised we anticipate price increases ranging from 6 percent to 15 percent for calendar year 1985." However, no evidence was presented as to test-year or prospective purchases

² Transcript of Evidence, April 4, 1985, p. 40.

³ Application, Schedule I, Adjustment 4.

from this vendor. Additionally, the price increase is anticipated, not known and measurable, and, therefore, not reliable as a basis for adjustments for rate-making purposes.

The Commission is of the opinion that the basis for this adjustment is speculative and sufficient information has not been provided whereby a known and measurable adjustment could be derived. Therefore, no adjustment has been allowed to increase these expenses for rate-making purposes herein.

Wages

Big Sandy proposed to increase total wages expense by \$15,509 to \$34,699.⁴ This adjustment was based on the test-year-end normalized salaries of its two current employees, and an additional full-time maintenance man not yet hired. Also included was a proposed wage increase of 7 percent to the normalized salaries.

The Commission's normal method for determining an appropriate level of wages and salaries is to normalize the test-year-end wages and salaries, and make adjustments to that amount based on known and measurable changes in staffing and wage levels scheduled to occur within a reasonable time subsequent to the test year. Although Big Sandy's application reflects that it intends to hire an additional maintenance man, no evidence has been presented in this proceeding as to when this position will be filled. Big Sandy's responses at the hearing indicated that the date of the hiring is still uncertain. Because it is now approximately 16

⁴ Application, Schedule 1a.

months beyond the end of the test year, and with the hiring date still uncertain, it is the Commission's determination that the allowance of the additional full-time maintenance man's salary for rate-making purposes is inappropriate. Likewise, Big Sandy stated at the hearing that the proposed 7 percent wage increase had not been granted nor authorized by the District's Commission. Therefore, the 7 percent wage increase has been excluded for rate-making purposes herein.

In determining an appropriate wage expense, the Commission has used test-year end normalized salaries for Big Sandy's two current employees, plus \$3,157 incurred for part-time labor during the test year. This results in a total allowable wage expense of \$24,157.

Non-Recurring Expenses

The staff audit report reflected that Big Sandy's 1983 operations expenses contained the cost of two financial audits. One audit was for the 12 months ended December 31, 1982. The additional audit was for the 6 months ended June 30, 1983, and was a one-time audit required by Farmers Home Administration to finalize financing for the construction of Big Sandy. It is the Commission's determination that this expense is of a non-recurring nature and, therefore, the full amount should not be recognized in annual operating expenses for rate-making purposes. Therefore, the cost of the 6-month audit, \$2,475, has been amortized over a 3-year period for the purpose of determining revenue requirements.

Taxes Other than Income

Big Sandy proposed an adjustment to increase taxes other than income taxes by \$2,045. This adjustment was based on the proposed wages at the current FICA rate of 7 percent. The Commission has allowed \$1,691 for FICA tax expense based on the total wages of \$24,157 allowed in a previous section of this Order.⁵ Additionally, the test-year actual level of unemployment taxes of \$378 and the Public Service Commission assessment of \$142 based on the 1984 assessment rate have been included herein. These adjustments result in total taxes other than income expense of \$2,211.

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

	<u>Test Year per Staff Audit</u>	<u>Pro Forma Adjustments</u>	<u>Test Period Adjusted</u>
Operating Revenues	\$127,864	\$ 21,310	\$149,174
Operating Expenses	<u>127,635</u>	<u>24,201</u>	<u>151,836</u>
Net Operating Income	\$ 229	\$ < 2,891 >	\$ < 2,662 >
Other Income	7,215	-0-	7,215
Interest Expense	<u>22,750</u>	<u>22,750</u>	<u>45,500</u>
Net Income	<u>\$ < 15,306 ></u>	<u>\$ < 25,641 ></u>	<u>\$ < 40,947 ></u>

REVENUE REQUIREMENTS

Big Sandy proposed that its revenue requirements be determined based upon a 1.2X debt-service coverage. The Commission is of the opinion that this approach is an appropriate criterion for determining revenues in this instance.

⁵ Section titled "Wages."

Using a debt-service coverage of 1.2X plus operating expenses, the Commission finds Big Sandy's total revenue requirement to be \$216,666.⁶ The Commission is of the opinion and finds that the revenue granted herein will produce gross annual revenue sufficient to pay Big Sandy's operating expenses, service its debt, and provide a reasonable surplus for equity growth.

SUMMARY

The Commission, having considered 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 Big Sandy and will produce gross annual revenue sufficient to pay its operating expenses, service its debt, and provide a reasonable surplus for equity growth.

2. The rates proposed by Big Sandy would produce revenue in excess of that found to be reasonable herein and, therefore, should be denied upon application of KRS 278.030.

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

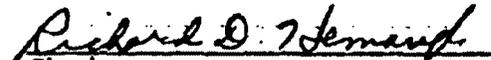
IT IS FURTHER ORDERED that the rates proposed by Big Sandy be and they hereby are denied.

<p>⁶</p> <ol style="list-style-type: none"> 1. Operating Expenses 2. Interest - LTD (1984 Actual) 3. Principal Pay (85-87 Avg.) 4. DSC: (Prin. + Int. Pymnts; 85-87 Avg.) X .20 	<p>\$151,836</p> <p>45,500</p> <p>8,667</p> <p>10,663</p> <p><u>\$216,666</u></p>
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IT IS FURTHER ORDERED that within 30 days from the date of this Order Big Sandy shall file with the Commission its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 13th day of May, 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. 9156, DATED 5/13/85

The following rates and charges are prescribed for the customers in the area served by the Big Sandy Water District. 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.

Minimum Bills

<u>Meter Size</u>	<u>Usage Allowance</u>	<u>Minimum Bills</u>
5/8 Inch	2,000 gallons	\$ 14.40
3/4 Inch	5,000 gallons	30.30
1 Inch	10,000 gallons	56.80
1 1/2 Inch	30,000 gallons	140.20
2 Inch	50,000 gallons	208.40
3 Inch	100,000 gallons	340.90
4 Inch	200,000 gallons	605.90

Metered Rates

<u>Rate Step</u>	<u>Rate Per 1,000 Gallons</u>
First 2,000 gallons	\$ 7.20
Next 8,000 gallons	5.30
Next 20,000 gallons	4.17
Next 20,000 gallons	3.41
Over 50,000 gallons	2.65