

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

* * * * *

In the Matter of:

THE APPLICATION OF BRONSTON)
WATER ASSOCIATION FOR AN)
ADJUSTMENT OF RATES PURSUANT TO) CASE NO. 9219
THE ALTERNATIVE RATE ADJUSTMENT)
FOR SMALL UTILITIES)

O R D E R

On November 19, 1984, Bronston Water Association ("Bronston") 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 \$27,774 annually based on the volumes of water sold during the test period. Based on adjusted volumes determined herein, Bronston's proposed rates would produce additional revenue of approximately \$21,445 annually, a 24 percent increase. Based on the determination herein, a deficiency of \$21,445 annually exists in the revenues of Bronston and, therefore, an adjustment in rates calculated to produce an estimated 24 percent increase in annual revenues has been granted in the total amount of \$21,445.

COMMENTARY

Bronston is a non-profit water distribution system organized and existing under the laws of the Commonwealth of Kentucky and serves approximately 590 customers in Pulaski and Wayne counties, Kentucky.

TEST PERIOD

Bronston 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 Bronston's 1983 Annual Report have been used as the basis for determining revenue requirements. Bronston proposed adjustments to revenue and expenses as reflected in the comparative income statement filed in Part II of its application. The Commission has made adjustments to reflect normal and anticipated operations adjusted for known and measurable changes which it deems to be fair and reasonable.

Revenue Normalization

The billing analysis filed by Bronston showed usage for the 12-month period ending December 31, 1983, to be 24,294,850 gallons and anticipated revenue from proposed rates of \$110,623. Revenue from test year rates and from current rates was not shown; however, application of the test year rates to the usage given in the billing analysis shows test year revenue of \$115,497, including \$29,709 from sales to its special contract customer, Woodson Bend Resort ("Woodson Bend"). Water service to Woodson Bend has now been discontinued. After adjustment for this revenue loss, Bronston's test year revenue from remaining customers would be \$85,788.

Effective March 27, 1984, Bronston was granted an increase of \$.13 per 1,000 gallons in Case No. 8800-1, Purchased Water Adjustment of Bronston Water Association. Application of the resulting rates to the billing analysis shows that revenue produced by the increased rates would be \$89,176. Bronston's test year revenue has, therefore, been increased by \$3,388 to reflect normalized revenue under the current rates.¹

Purchased Water

Bronston reported \$56,162 in test period purchased water cost. Bronston proposed a \$17,405 reduction in this cost due to the 15,822 thousand gallons of lost sales to the Woodson Bend Subdivision. The proposed reduction of \$17,405 to water purchases did not consider the test period reported line loss of 12 percent. In response to a Commission request, Bronston provided the actual gallonage of 16,998 thousand gallons sold to Woodson Bend during the test period. In consideration of the actual gallonage, the actual purchased water costs of \$1.10 per thousand gallons and the average system line loss, the Commission has determined that a reduction of \$21,247 to test period purchased water costs is appropriate and has therefore reduced test period purchased water costs by \$21,247 to \$34,915 annually.

¹

\$115,497
- 29,709
<u>\$ 85,788</u>
+ 3,388
<u>\$ 89,176</u>

Maintenance of Mains

Bronston reported \$14,661 in test period maintenance of mains expense. In response to a Commission request, Bronston provided a breakdown of this expense. Included in this breakdown were invoices in the amount of \$125, \$220 and \$258 expended for the installation of 2-inch distribution lines. Also included was an invoice of \$6,129 expended for the installation of 3-inch transmission lines.

The Commission is of the opinion that expenditures for such fixed assets provide benefits to the organization for longer than a single period and that the benefit derived from these assets should be recognized in depreciation expense over the respective useful lives. The Commission concludes that the amounts expended for the 2-inch distribution lines and the 3-inch transmission line were improperly expensed and should be capitalized. Therefore, the Commission has reduced test period maintenance of mains account by \$6,732 to exclude the improperly expensed capital items.

Outside Services

Bronston reported \$9,835 in test period outside services. A breakdown of this amount disclosed that \$6,495 of this amount was paid to Ms. Pamela Johnson and Mr. Dell Coleman for rate case expenses in Case No. 8800, Bronston Water Association, Inc. In response to a Commission request, Bronston stated that these charges were not normal or recurring.²

² Response to Item 1 of Commission request dated March 7, 1985.

The ARF procedure is not intended to encompass extensive legal or complicated accounting and engineering issues and was designed specifically to allow filing by utility personnel without acquiring professional services. Therefore, sophisticated accounting, expert witnesses and extensive legal representation are not necessary under the ARF procedure. The Commission has taken the position in numerous cases that a typical ARF procedure with limited filing requirements and no hearing should cost no more than \$1,000 unless extenuating circumstances merit a greater cost.

In its Order in Case No. 8800 issued in September, 1983, the Commission found that rate case expense in excess of \$1,000 was justified and allowed a total of \$4,500 for rate case expenses which was amortized over 3 years at a rate of \$1,500 per year for rate-making purposes. As of this writing, 21 months have lapsed since the Commission's Final Order in Case No. 8800; resultingly, there remains approximately \$1,875 unamortized balance of rate case expenses allowed for rate-making purposes.

The Commission concurs with Bronston in that the \$6,495 expensed during the test period for prior rate case expenses is not a normal, recurring expense relative to Bronston's annual operating costs. These costs, to the extent justified, should be included for rate-making purposes in amortization expense. The Commission has reduced test period outside services by the \$6,495 to exclude the expenses related to Bronston's prior rate case and has increased outside services by \$958 based on a 3-year amortization of the allowed \$1,000 in rate case expenses and the

unamortized balance of \$1,875 in prior rate case expenses. The net effect of these two adjustments to test period outside services is to reduce the outside services expense by \$5,537.

Miscellaneous General Expenses

Bronston reported \$4,093 in test period miscellaneous general expenses. A breakdown of this expense account revealed that \$1,627 of the total annual expense was expended to volunteers during a water shortage emergency.³ The Commission is of the opinion that expenditures of an emergency nature are not normal recurring cost of service expenses and, as such, are not normally allowable for rate-making purposes. However, Bronston's customers were the recipients of these emergency services, and the expenditure of \$1,627 was not imprudent relative to the nature and amount of services provided. Furthermore, prior approval from the Commission for these expenditures would not have been timely in such an emergency situation. The Commission is of the opinion that Bronston should recover these costs over a 3-year period and has allowed for rate-making purposes amortization over 3 years of \$1,627 or \$542 of the emergency expenditures annually. Therefore, the Commission has reduced miscellaneous general expenses by \$1,085 annually.

³ Response to Item 7 of Commission request of January 15, 1985.

Depreciation Expense

Bronston reported \$15,491 in test period depreciation expense. Bronston's balance sheet reflects \$624,893 in utility plant in service which was partially funded by a reported \$261,290 in Contributions in Aid of Construction. Additionally, \$27,000 of Contributions in Aid of Construction were unaccounted for in the annual report.⁴

The Commission is of the opinion that depreciation expense represents a return of invested capital for rate-making purposes and, as such, water districts have no invested capital to the extent of Contributions in Aid of Construction. Therefore, depreciation expense associated with Contributions in Aid of Construction is not allowable for rate-making purposes.

In this case, Contributions in Aid of Construction represent approximately 46 percent of utility plant in service. Consequently, the Commission has excluded \$7,146 of depreciation expense (approximately 46 percent) for rate-making purposes. In recognition of items capitalized in a previous section herein, the Commission has increased test period depreciation expense by \$117 through the depreciation of \$603 of 2-inch distribution lines and \$6,129 of 3-inch transmission lines over their respective useful lives of 40 and 60 years.

The net effect of these adjustments is to reduce depreciation expense by \$7,029 for rate-making purposes.

⁴ . Response to Item 10 of Commission request of January 15, 1985.

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

	<u>Reported Test Period</u>	<u>Pro forma Adjustments</u>	<u>Adjusted Test Period</u>
Total Operating Revenues	\$ 115,005	\$(23,712)	\$ 91,293
Operating Expenses	131,955	(41,630)	90,325
Net Operating Income	<u>\$(16,950)</u>	<u>\$ 17,918</u>	<u>\$ 968</u>
Interest Income	4,233	-0-	4,233
Interest Expense	10,860	-0-	10,860
Net Income	<u><u>\$(23,577)</u></u>	<u><u>\$ 17,918</u></u>	<u><u>\$(5,659)</u></u>

REVENUE REQUIREMENTS

Bronston's debt service, based on the average principal and interest payments due within the next 5 years, is \$22,387 annually. The adjusted test-period operating statement reflects a net loss of \$5,659 which provides inadequate coverage on Bronston'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 Bronston. The Commission deems that a 1.2X debt service coverage is fair and reasonable and, to improve Bronston's financial condition, additional revenues of \$21,445 will be required. Based on adjusted test period results, total revenue of \$112,738 will produce net operating income of \$22,413 which, after considering other income of \$4,233, will be sufficient to allow Bronston to pay its operating expenses and provide a 1.2X debt service coverage on its annual debt service obligations.

RATE DESIGN

Bronston proposed to change its rate design by applying the proposed increase so as to readjust the revenue generated at the various rate levels, resulting in successively higher increases ranging from 21.42 percent at the minimum level to 54.13 percent for usage over 15,000 gallons. In response to the Commission's information request of January 15, 1985, Bronston stated the proposed change in rate design was an "effort to equalize the charge so that the customers having the larger usage levels will pay a larger share of the operating costs of the Association."

It is an accepted premise that, unless some unusual circumstance exists, the greater the usage, the lower the per unit cost of providing service. Therefore, the fixed costs of providing service are included in the minimum bill and subsequent rate blocks on a declining basis in addition to the cost of purchased water. All of Bronston's customers are billed on the same rate schedule; thus, all customers, including large users, pay for the cost of service proportionate to the cost incurred.

No cost data or other justification was filed by Bronston to support its proposal to require larger users to pay a greater share of the operating costs than other users.

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 Bronston in that they will produce annual operating revenues from water sales of approximately \$110,621 and should be

approved. These revenues will be sufficient to meet Bronston's operating expenses found reasonable for rate-making purposes, service its debt and provide a reasonable surplus.

2. Bronston failed to provide sufficient justification for the proposed change in rate design. Therefore, the proposed rates, insofar as they result in a change in rate design, should be denied.


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


IT IS FURTHER ORDERED that the change in rate design proposed by Bronston be and it hereby is denied.


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

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. 9219 DATED JULY 12, 1985

The following rates and charges are prescribed for the customers receiving water service from Bronston Water Association. 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.

<u>USAGE BLOCKS</u>	<u>MONTHLY RATES</u>
First 1,500 gallons	\$ 8.65 Minimum
Next 3,500 gallons	3.60 per 1,000 gallons
Next 5,000 gallons	2.65 per 1,000 gallons
Next 5,000 gallons	2.05 per 1,000 gallons
Over 15,000 gallons	1.65 per 1,000 gallons