

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

SANITATION DISTRICT NO. II OF)
MCCRACKEN COUNTY, KENTUCKY -)
APPLICATION FOR SEWER RATE) CASE NO. 9252
INCREASE AND ORDER ALLOWING THE)
PUBLISHING OF A NEW TARIFF FOR)
AN INCREASE IN SEWER RATES)

O R D E R

Sanitation District No. II of McCracken County ("McCracken County") filed an application on January 2, 1985, for approval to increase rates. The proposed rates would produce additional revenue of approximately \$44,108 annually, an increase of 33.7 percent. Based upon the determination herein, the operating revenue of McCracken County will increase by \$40,464 annually over normalized test-year operating revenue, an increase of 30.9 percent.

A hearing was held on May 8, 1985, in the offices of the Public Service Commission in Frankfort, Kentucky. At the hearing, certain requests for additional information were made. This information has been filed.

TEST PERIOD

McCracken County has proposed and the Commission has accepted the 12-month period ending September 30, 1984, 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

McCracken County proposed adjustments to revenues and expenses as reflected in the Comparative Income Statement filed in the application as Exhibit No. 3. 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:

Salaries

Harold E. Medley, Superintendent and Chief Operator, and Jerry D. Cornwell, Assistant Operator, both received raises during the test year. On August 1, 1984, Mr. Medley received a 4 percent merit raise and Mr. Cornwell received a 5 percent merit raise.¹ Even though McCracken County did not propose an adjustment to annualize these expenses, the Commission is of the opinion that such an adjustment is justified and should be made to reflect normal on-going costs. Therefore, an additional \$1,307 has been included herein for salaries expense.

Materials and Supplies, Repair

McCracken County's Materials and Supplies, Repair expense for the test year was \$18,121 and no adjustment to this expense was proposed. However, it is the Commission's opinion that the two sump pumps purchased during the test year for \$547 have a

¹ Response, Commission's Information Request of February 4, 1985, Item No. 8.

useful life of more than 1 year and should have been capitalized and depreciated over 5 years in accordance with generally accepted accounting principles. Therefore, the Materials and Supplies, Repairs expense has been reduced by \$547 and the total depreciation expense increased by \$109.

Other Income

During the test year, McCracken County realized a \$1,350 gain on the sale of a truck. McCracken County did not propose an adjustment to exclude this item from the test-year Other Income. During the hearing, Michael Trundle, CPA, McCracken County's accountant, stated that this gain should have been excluded from the test year.² The Commission is of the opinion that this gain should be excluded since it is of a non-recurring nature, and has reduced Other Income by \$1,350.

Engineering

Hunter H. Martin & Associates has provided professional engineering services and bookkeeping services for McCracken County since its formation. Currently, they are under a retainer agreement with McCracken County at \$180 per month. Under this agreement, Hunter H. Martin provides engineering services, including advising McCracken County about maintenance and operational procedures, and the purchasing of materials, supplies and equipment. The bookkeeping service provided by Hunter H. Martin

² Transcript of Evidence, May 8, 1985, pp. 55-56.

includes paying McCracken County's bills and posting all transactions to the journal and the ledger. Any additional work performed by Hunter H. Martin for McCracken County is to be performed under a separate contract or on a per-hour basis, with the rates in Schedule B of the retainer agreement to be in effect. The preparation of the rate case was performed by Hunter H. Martin on a per-hour basis.

The Commission is of the opinion that this arrangement could result in excessive costs and may be a direct conflict of interest inasmuch as a party who not only performs services for McCracken County also pays the bills. Therefore, the Commission finds that McCracken County should review the economic benefits of this arrangement to determine whether this is in the best interests of McCracken County and its consumers. The analysis should consider initiating a manager position to handle the day-to-day routine operations of McCracken County instead of relying solely on the services of Hunter H. Martin & Associates.

In future rate case proceedings McCracken County will be expected to show with verifiable evidence that the existing arrangement at that time has resulted in the most reasonable level of expense.

Rate Case Expense

McCracken County estimated that its total rate case expense would be \$9,600 per the original application. However, due to the costs associated with responses to the Commission's Information Requests, the revised total rate case expense was \$14,013. The Commission staff requested details regarding the initial

engineering fee of \$5,404 charged by Hunter H. Martin which would reflect the services performed for this amount. However, no details of the services rendered were provided. A review of the data contained in the original application reflects that most of the detailed work was prepared by the accountant. The Commission is of the opinion that the \$5,404 charged by Hunter H. Martin for the preparation of the application is excessive and should not be included for rate-making purposes. Therefore, the \$5,404 has been excluded from the total rate case expense.

It was estimated in the application that the total rate case cost would include approximately \$900 for legal expense and \$500 for the Director's expenses for attending the hearing. Since these costs have not been verified through the submission of invoices, they have also been excluded from the total rate case cost. Therefore, the total rate case expense allowed is \$7,209, which shall be amortized over 3 years for an annual expense of \$2,403.

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

	<u>Actual Test Period</u>	<u>Adjustments to Test Period</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$131,842	\$ -0-	\$131,842
Operating Expenses	<u>120,120</u>	<u>< 7,124 ></u>	<u>112,996</u>
Net Operating Income	\$ 11,722	\$ 7,124	\$ 18,846
Other Income	13,389	< 1,350 >	12,039
Other Deductions	58,359	<13,150 >	45,209
Net Income (Loss)	<u>\$ <33,248 ></u>	<u>\$ 18,924</u>	<u>\$ <14,324 ></u>

REVENUE REQUIREMENTS

The Commission is of the opinion that the adjusted test-period operating loss is clearly unjust and unreasonable. Pursuant to McCracken County's bond indenture, McCracken County is required to have sufficient revenues to meet the operating expenses, exclusive of allowances for depreciation, and have a 1.5X debt service coverage. The Commission finds this method to be a fair, just and reasonable method of determining revenue requirements in this case and adequate to allow McCracken County to pay its operating expenses, meet its debt-service requirements and maintain a reasonable surplus. Therefore, the Commission finds that McCracken County is entitled to an increase in annual revenues of \$40,464.

RATE DESIGN

In its application, McCracken County proposed a declining block rate design with rates based on each customer's water usage. McCracken County also proposed to reduce the number of blocks in its rate schedule from six to three.

In an information request the Commission asked that McCracken County provide an alternative flat rate schedule. In a response received April 2, 1985, McCracken County proposed a flat rate of \$11.24 for all customers. The Commission is of the opinion that McCracken County has more than one class of customers; therefore, a separate flat rate for each class should be granted in this case. Furthermore, the rates shown in Appendix A are the fair, just and reasonable rates to be charged.

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. The rates in Appendix A are fair, just and reasonable rates for McCracken County and will produce annual sewer revenue of approximately \$171,427. This revenue, when combined with other operating revenue of \$879 and interest income of \$12,037, will be sufficient to allow McCracken County to pay its allowable operating costs, service its debt and provide a reasonable surplus.

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

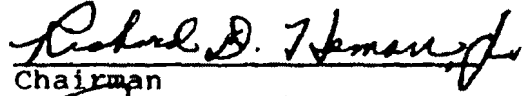
IT IS THEREFORE ORDERED that the rates in Appendix A be and they hereby are approved for service rendered by McCracken County on and after the date of this Order.

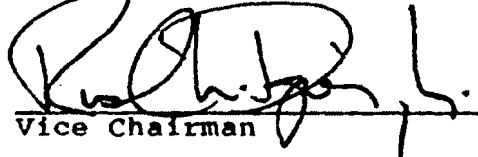
IT IS FURTHER ORDERED that the rates proposed by McCracken County be and they hereby are denied.

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

Done at Frankfort, Kentucky, this 23rd 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. 9252 DATED JULY 23, 1985

The following rates and charges are prescribed for the customers in the area served by Sanitation District II of McCracken County. 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>Customer Class</u>	<u>Rate</u>
Residential/ Duplex (per unit)	\$ 8.30
Apartment (per unit)	6.22
Commercial(*)	
Institutional/Governmental	\$18.34

(*) The number of residential equivalents and/or fractional parts thereof shall be determined by dividing the customer's average monthly water consumption in gallons by 12,000 gallons. The minimum bill for this type service shall be \$ 8.30.