COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

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| THE APPLICATION OF WEST MCCRACKEN WATER DISTRICT FOR AN ADJUSTMENT OF RATES PURSUANT TO THE ALTERNATIVE RATE ADJUSTMENT FOR SMALL UTILITIES | ) | CASE NO. 9286 |

O R D E R

On February 27, 1985, West McCracken Water District ("West McCracken") 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 application requested an increase of 15 percent; however, the application was amended on July 11, 1985, to request an increase of 20 percent, which would result in an increase of approximately $35,768 over test-year operating revenues from rates.

On August 15, 1985, the Commissioners of Paducah Water Works, by counsel, and a group of consumers and ratepayers of West McCracken, by counsel, filed motions for full intervention in this proceeding and requested a hearing to present evidence in support of a merger between West McCracken and Paducah. These motions were sustained and no other party formally intervened. A hearing was scheduled for October 8, 1985, for the purpose of cross-examination of the witnesses of West McCracken and the intervenors. West McCracken was directed to give notice to its customers of the proposed rates and scheduled hearing pursuant to

807 KAR 5:011, Section 8. The hearing was held as scheduled in the Commission's offices in Frankfort, Kentucky, with all parties of record represented. Briefs were filed by November 7, 1985, and the information requested during the hearing has been submitted.

This Order addresses the Commission's findings and determinations on issues presented and disclosed in the hearing and investigation of West McCracken's revenue requirement and rate design, and provides rates and charges that will produce an increase in annual revenues of $22,617.

## COMMENTARY

West McCracken is a non-profit water district organized and existing under the laws of the Commonwealth of Kentucky and serves approximately 668 customers in McCracken County, Kentucky.

## TEST PERIOD

West McCracken has 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 ARF was established to provide a simplified and less expensive method for small utilities to apply for rate increases with the Commission. The financial data from the 1983 Annual Report have been used as the basis for determining revenue requirements. West McCracken proposed adjustments to revenues and expenses to reflect levels equal to the amounts incurred during the year ended November 31, 1984. The Commission does not accept inflationary-type adjustments. Instead, the Commission requires that adjustments be known and measurable and that each adjustment be documented and supported on its own merit. The effect of West McCracken's proposal is to project operations based on the results of a more current period. This procedure is tantamount to updating the test year. All of the Commission's queries in this proceeding have addressed 1983 operations. Accepting West McCracken's proposal would require the Commission to, in a sense, start over again because 1984 operations would then have to be evaluated in the same manner as 1983 operations have been evaluated. Therefore, the Commission will not allow the proposed adjustment to adjust all revenue and expense accounts to 1984 levels.

As explained hereafter, the Commission has made adjustments to reflect actual and anticipated operating conditions which the Commission deems are proper and acceptable for rate-making purposes.

Items Improperly Expensed

In order to verify reported test-year Operation and Maintenance Expenses, the Commission requested breakdowns of test-year charges to selected accounts.[1] An examination of these breakdowns reflected that three of the test-year expenditures

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1 Response to Item No. 2, Commission's letter dated March 28, 1985.

would benefit more than one accounting period and were of a material amount.

The three expenditures are as follows:

| Date, Ck.#, Payee, Description | Amount | Acct. No. Chg'd | Corr. Acct. No. | Dep. Rate | Ann'l Dep. |
|---|---|---|---|---|---|
| 12/4/83 Ck.#6434 to B. L. Anderson: Repair to chart recorder | $ 956 | 623 | 395 | 10% | $ 96 |
| 11/2/83 Ck.#6382 to G&C Water Works: 6 copper setters, 6 corporation stops | 251 | 652 | 345 | 2% | 5 |
| 05/5/83 Ck.#6142 to Tri-State: 5 meters, yokes, saddles | 445 | 653 | 346, 347 | 10% | 45 |
| | $1,652 | | | | $ 146 |

Expenditures benefiting more than one accounting period and of a material amount should be charged to Utility Plant in Service accounts and depreciated over its useful life. Therefore, the Commission has reduced test-year Operation and Maintenance expenses by $1,652, and has concurrently increased depreciation expense by $146, as determined in the preceding table.

Depreciation Expense

West McCracken reported test-year depreciation expense of $19,314. No adjustment to this level of expense was proposed by West McCracken.

The Commission endorses the theory that the ratepayers should pay only for the plant in which the utility has made an investment, and not the plant which the utility has acquired through contributions. Accordingly, the Commission has computed allowable depreciation expense for rate-making purposes on non-contributed plant only. This results in $15,766 as the allowable depreciation expense. This amount represents 81.6 percent of the total reported depreciation expense, which is equal to the ratio of non-contributed property to total Utility Plant in Service.

As explained in the previous section, a further adjustment of $146 has been made to reflect the capitalization of items improperly expensed. This results in a total depreciation expense of $15,912.

Rate Case Expense

West McCracken reported expenses associated with the processing of this rate case of $572.[2] This represents 13 hours of accounting labor at $44 per hour. The Commission is of the opinion that this expense should be amortized for rate-making purposes and, therefore, has increased amortization expense by $191 to reflect the amortization of this amount over a 3-year period.

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

| | Actual Test Period | Pro Forma Adjustments | Adjusted Test Period |
|---|---|---|---|
| Operating Revenues | $180,935 | $ -0- | $ 180,935 |
| Operating Expenses | 166,192 | <4,863> | 161,329 |
| Operating Income | $ 14,743 | $ 4,863 | $ 19,606 |
| Other Income | 1,176 | -0- | 1,176 |
| Other Deductions | 38 | -0- | 38 |
| Interest - LTD | 26,920 | <405> | 26,515 |
| | $<11,039> | $ 5,268 | $ <5,771> |

2 Response to Item No. 7, Commission's letter dated March 20, 1985.

## REVENUE REQUIREMENTS

In its application, West McCracken did not propose a method to be used for determining revenue requirements. In its letter dated June 14, 1985, the Commission requested information on this issue, including a request for a copy of the calculation showing the derivation of the proposed increase. However, West McCracken's response, filed July 11, 1985, did not address the issue of revenue requirements determination. Furthermore, the February 28, 1968, Department of Housing and Urban Development bond ordinance does not specify earnings requirements related to the initial bond issue. Therefore, no earnings requirements have been presented as a matter of record in this case.

In determining an appropriate revenue requirement, the Commission has considered the historical operations, test-year operations, and prospective operations of West McCracken, and has determined that a 1.5 debt service coverage, excluding depreciation expense, will be sufficient to allow it to pay its operating expenses, meet its debt service requirements, and provide sufficient cash flow to fund routine construction and maintain an adequate surplus. This method results in a total revenue requirement of $204,728, and a revenue requirement from rates of $201,457. These amounts are calculated as follows:

| | |
|---|---|
| Total O & M Expenses, excluding depreciation | $145,417 |
| Interest | 26,515 |
| Principal | 13,000 |
| .5 Debt Service coverage | 19,758 |
| Other Expense | 38 |
| Total Revenue Requirement | $204,728 |
| Less: | |
| Income not generated from rates: | |
| Private Fire Protection | 300 |
| Forfeited Discounts | 1,795 |
| Other Income | 1,176 |
| Revenue Requirement from Rates | $201,457 |

## RATE DESIGN

West McCracken's tariff contains separate rate schedules for the following size meters: 5/8-inch, 3/4-inch, 1-inch, 1 1/2-inch, 2-inch, 3-inch and 4-inch. These rate schedules contain minimum usage levels ranging from 2,000 gallons to 150,000 gallons, based on the flow capacity of the particular size meter, for which the customer must pay even though the actual usage may be less. The minimum bills for these usage levels are based on the cost of that volume of water when calculated according to the 5/8-inch meter rate schedule, with usage above the minimum also charged according to succeeding rates in the same rate schedule.

West McCracken serves one industrial customer, Essex Wire, Inc., ("Essex") on a special 2-step rate schedule with a minimum usage of 625,000 gallons and all usage in excess of the minimum charged at a flat rate of $1.25 per 1,000 gallons. The charges to Essex are less than charges to other customers.

West McCracken proposed what is substantially a change in rate design by redistributing its revenue through an increase of approximately 20 percent for other customers and approximately 13 percent for Essex.

While it is accepted that the per unit cost is less with the larger volume of sales, this factor has been previously considered in establishing the current rate schedule for Essex. Subsequent increases in costs would apply proportionately regardless of sales volume. One of the increased expenses upon which West McCracken is relying to justify the adjustment to its rates is an increase in the cost of water purchased from its supplier, Paducah Water Works, of approximately 17 1/2 percent, which West McCracken has absorbed since April, 1982. This increased expense alone, which applies equally to all water usage is greater than the increase proposed for Essex.

The Commission is of the opinion that the proposed change in rate design is unfair, unjust and unreasonable in that it would result in an unreasonable difference between classes of customers receiving substantially the same service. The Commission has, therefore, established rates providing for proportionate increases to all customers based on the revenue found reasonable herein.

## MERGER OR ACQUISITION FEASIBILITY

West McCracken is a non-profit water utility engaged in the distribution and sale of water to approximately 668 customers in western McCracken County, Kentucky. There are four other non-profit water utilities currently providing water service in McCracken County: Hendron Water District, Lone Oak Water District, Reidland Water District, and the Massac Water Association, Inc. In addition, Paducah Water Works serves customers in a portion of McCracken County.

The Paducah Water Works presented evidence to support its arguments that West McCracken would not need the rate adjustment requested herein if it would merge with Paducah's municipal system and that the Commission should defer any rate relief until West McCracken has engaged in good faith discussions regarding such a merger.

The Commission is under an affirmative duty to insure that customers receive adequate, efficient and reasonable utility service (KRS 278.030). In addition, KRS 74.361 states in part that:

> The general assembly of the Commonwealth of Kentucky determines as a legislative finding of fact that reduction of the number of operating water districts in the Commonwealth will be in the public interest, in that mergers of such districts will tend to eliminate wasteful duplication of costs and efforts, result in a sounder and more businesslike degree of management and ultimately result in greater economies, less cost, and a higher degree of service to the general public; and that the public policy favors the merger of water districts wherever feasible.

Mr. W. N. Mansfield, Treasurer of West McCracken, testified that the water district has not formally investigated the possibility of merging with any of the water systems near it in McCracken County. In view of the legislative mandate, the Commission is of the opinion that West McCracken should engage in good faith discussions with the Paducah Water Works to examine all potential operating efficiencies available through joint operation or merger. West McCracken should also meet with each of the non-profit water systems in McCracken County to discuss the feasibility of a merger. The Commission further finds that it is not appropriate to withhold rate relief found necessary herein solely to afford West McCracken an opportunity to consider merger possibilities.

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 West McCracken 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 proposed change in rate design is unfair, unjust, and unreasonable and should be denied.

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

4. West McCracken should investigate the feasibility of merging with the other non-profit water utilities in McCracken County as well as the feasibility of finalizing any reasonable acquisition offers from the Paducah Water Works. West McCracken should file a written report on the results of its investigation with the Commission within 90 days of the date of this Order.

IT IS THEREFORE ORDERED that:

1. The rates and the change in rate design proposed by West McCracken be and they hereby are denied.

2. The rates in Appendix A be and they hereby are approved for service rendered by West McCracken on and after the date of this Order.

3. Within 30 days from the date of this Order West McCracken shall file with this Commission its revised tariff sheets setting out the rates approved herein.

4. West McCracken shall investigate and engage in good faith discussion with the Paducah Water Works and the other non-profit water utilities in McCracken County regarding the feasibility of merger. Within 90 days of the date of this Order, West McCracken shall file with the Commission a written report setting forth the results of its investigation and discussions.

Done at Frankfort, Kentucky, this 11th day of December, 1985.

PUBLIC SERVICE COMMISSION

Richard D. Heman Jr.
Chairman

Vice Chairman

Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 9286 DATED DECEMBER 11, 1985

The following rates and charges are prescribed for customers receiving water service from West McCracken 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.

5/8-INCH METER

| Usage Block | Monthly Rate |
|---|---|
| First 2,000 gallons | $8.55 Minimum |
| Next 3,000 gallons | 4.00 per 1,000 gallons |
| Next 5,000 gallons | 3.50 per 1,000 gallons |
| Next 40,000 gallons | 2.90 per 1,000 gallons |
| Next 50,000 gallons | 2.60 per 1,000 gallons |
| Next 400,000 gallons | 2.00 per 1,000 gallons |
| Over 500,000 gallons | 1.50 per 1,000 gallons |

3/4-INCH METER

| Usage Block | Monthly Rate |
|---|---|
| First 4,000 gallons | $16.55 Minimum |
| Next 1,000 gallons | 4.00 per 1,000 gallons |
| Next 5,000 gallons | 3.50 per 1,000 gallons |
| Next 40,000 gallons | 2.90 per 1,000 gallons |
| Next 50,000 gallons | 2.60 per 1,000 gallons |
| Next 400,000 gallons | 2.00 per 1,000 gallons |
| Over 500,000 gallons | 1.50 per 1,000 gallons |

## 1-INCH METER

| Usage Block | Monthly Rate |
|---|---|
| First 7,500 gallons | $29.30 Minimum |
| Next 2,500 gallons | 3.50 per 1,000 gallons |
| Next 40,000 gallons | 2.90 per 1,000 gallons |
| Next 50,000 gallons | 2.60 per 1,000 gallons |
| Next 400,000 gallons | 2.00 per 1,000 gallons |
| Over 500,000 gallons | 1.50 per 1,000 gallons |

## 1 1/2-INCH METER

| Usage Block | Monthly Rate |
|---|---|
| First 15,000 gallons | $52.55 Minimum |
| Next 35,000 gallons | 2.90 per 1,000 gallons |
| Next 50,000 gallons | 2.60 per 1,000 gallons |
| Next 400,000 gallons | 2.00 per 1,000 gallons |
| Over 500,000 gallons | 1.50 per 1,000 gallons |

## 2-INCH METER

| Usage Block | Monthly Rate |
|---|---|
| First 30,000 gallons | $96.05 Minimum |
| Next 20,000 gallons | 2.90 per 1,000 gallons |
| Next 50,000 gallons | 2.60 per 1,000 gallons |
| Next 400,000 gallons | 2.00 per 1,000 gallons |
| Over 500,000 gallons | 1.50 per 1,000 gallons |

## 3-INCH METER

| Usage Block | Monthly Rate |
|---|---|
| First 75,000 gallons | $219.05 Minimum |
| Next 25,000 gallons | 2.60 per 1,000 gallons |
| Next 400,000 gallons | 2.00 per 1,000 gallons |
| Over 500,000 gallons | 1.50 per 1,000 gallons |

## 4-INCH METER

| Usage Block | Monthly Rate |
|---|---|
| First 150,000 gallons | $ 384.05 Minimum |
| Next 350,000 gallons | 2.00 per 1,000 gallons |
| Over 500,000 gallons | 1.50 per 1,000 gallons |

## ESSEX WIRE, INC.

| Usage Block | Monthly Rate |
|---|---|
| First 625,000 gallons | $1,525.00 Minimum |
| Over 625,000 gallons | 1.45 per 1,000 gallons |