

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF FOUR-WAY ENTERPRISES,)
INC., FOR A RATE ADJUSTMENT PURSUANT TO) CASE NO.
THE ALTERNATIVE RATE FILING PROCEDURE) 91-394
FOR SMALL UTILITIES)


O R D E R

On November 11, 1991, Four-Way Enterprises, Inc. ("Four-Way") filed its application for Commission approval of a proposed increase in its rates for water service. Commission staff, having performed a limited financial review of Four-Way's operations, has prepared the attached staff report containing staff's findings and recommendations regarding the proposed rates. All parties should review the report carefully and provide any written comments or requests for a hearing or informal conference no later than 15 days from the date of this order.

IT IS THEREFORE ORDERED that all parties shall have 15 days from the date of this Order to provide written comments regarding the attached staff report or requests for a hearing or informal conference. If no request for a hearing or informal conference is received, then this case will be submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this 30th day of January, 1992.

PUBLIC SERVICE COMMISSION


For the Commission

ATTEST:


Executive Director

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF 4-WAY ENTERPRISES,)
INC. FOR A RATE ADJUSTMENT PURSUANT) CASE NO. 91-394
TO THE ALTERNATIVE RATE FILING)
PROCEDURE FOR SMALL UTILITIES)

STAFF REPORT

January 23, 1992

Prepared By: Karen Harrod
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Analyst, Chief
Water and Sewer Revenue
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Communications, Water and
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Research Division

STAFF REPORT

ON

4-Way Enterprises

CASE NO. 91-394

A. Preface

On October 29, 1991, 4-Way Enterprises, Inc. ("4-Way") submitted an application to the Commission seeking to increase its rates pursuant to the Alternative Rate Filing Procedure for Small Utilities. The application was considered filed on November 7, 1991. The proposed rates were designed to generate approximately \$10,686 in additional revenues, an increase of 19.8 percent over normalized test-year operating revenues from water sales of \$53,975.

In order to evaluate the requested increase, the Commission Staff ("Staff") chose to perform a limited financial review of 4-Way's operations for the test period, calendar year 1990. Karen Harrod of the Commission's Division of Rates and Tariffs conducted the review on December 6, 1991 at the office of 4-Way's CPA, Weinberg & O'Koon, in Louisville, Kentucky. Nicky Moore, of the Research Division performed his review of the billing analysis at the Commission's office in Frankfort, Kentucky.

The findings of the field review have been reduced to writing in this report. Nicky Moore is responsible for the sections related to operating revenue and rate design. The remaining sections of the Staff Report were prepared by Karen Harrod.

Based upon the findings of this report, Staff recommends that 4-Way be allowed to increase its annual revenues by \$7,130, an increase of 13.2 percent.

Scope

The scope of the review was limited to obtaining information to determine whether test-period operating revenues and expenses were representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

B. Revenue Requirements Determination

Operating Revenues

4-Way reported test year revenue of \$53,319. Its application indicates that, at the time of filing, it had 282 customers. This number of customers would generate \$53,974.80¹ in revenue annually at current rates, a difference of \$655.80 over actual test-period revenue collected.

Operating Expenses

For the test period 4-Way reported operating expenses of \$55,231. Adjustments were proposed to increase total operating expenses to a level of \$56,577. These adjustments and Staff's recommendations are discussed in the following sections of this report.

Owner/Management Fee

4-Way reported owner/management fees expense of \$4,500 for the test year. An adjustment was proposed to increase this amount

¹ Flat Rate of \$15.95 per month x 282 customers x 12 months = \$53,974.80.

by \$300 to allow for a monthly fee of \$400 or total annual expense of \$4,800. In its application 4-Way provided a list of the management responsibilities required of the owner, Mr. Carl Sturgeon. It is Staff's opinion that the services performed by Mr. Sturgeon are similar to those performed by the owners of comparable utilities. Therefore, Staff has limited the owner/management fee to the maximum fee currently allowed by the Commission which is \$2,400. Accordingly, an adjustment has been made to decrease test-year expense by \$2,100.

Testing Expense

For the test year 4-Way reported testing expense of \$2,300. 4-Way proposed to increase this amount by \$100 based on a price quote from Kenvirons, Inc. to perform the appropriate monthly water testing procedures for a fee of \$200 per month. Staff has reviewed the contract and is of the opinion that this adjustment meets the rate-making criteria of being known and measurable. Therefore, an adjustment has been made to increase testing expense to a level of \$2,400.

Purchased Power

Purchased power expense of \$9,619 was reported for the test year. After reviewing the expenses supporting this expense, Staff calculated normalized test year purchased power expense to be \$9,659. Accordingly, Staff recommends an increase to test year expense of \$40.

Routine Maintenance Fee

For the test period 4-Way reflected total routine maintenance fees of \$4,800. An adjustment was proposed to increase this

amount to \$5,400 based on monthly fees of \$450. In its application 4-Way included contracts to support these monthly fees. One contract reflects an agreement with Mr. Frank McDonald wherein he will make daily inspections of the plant and two lift stations and report any problems to Mr. Sturgeon or the plant operator at a cost of \$50 per month. The other contract represents an agreement with Mr. Glen Sanford to perform the duties of plant operator for a monthly fee of \$400.

Staff is of the opinion that these contracts are reasonable and that these fees should be included in the calculation of 4-Way's revenue requirement. Accordingly, an increase of \$600 has been made to test year routine maintenance fees expense.

Agency Collection Fee

4-Way reported test year agency collection fee expense of \$7,998. This fee is paid to Farmdale Water District ("Farmdale") for monthly billing and collection services. The fee charged by Farmdale is calculated based on 15 percent of 4-Way's gross revenues. Based on Staff's recommended increase of \$656 to normalize test-year revenues, an adjustment has been included to increase agency collection fees expense by \$98.²

Staff recommends that 4-Way consider available alternatives to its present billing and collection agreement. It further recommends that the Commission require 4-Way, when filing its next rate application, to demonstrate that its billing and collection

² \$656 x 15% = \$98

agreement with Farmdale Water District is prudent and reasonable in light of other alternative methods available to 4-Way.

Insurance Expense

Insurance expense of \$1,791 was reported for the test period. In its application 4-Way proposed to decrease this expense by \$599 to reflect the level of expense incurred in 1991, subsequent to the test year. Staff is of the opinion that this adjustment is reasonable and appropriate for rate-making purposes. Accordingly, 4-Way's test-year operations have been adjusted to reflect insurance expense of \$1,192.

Miscellaneous Expense

4-Way reported test-year miscellaneous expense of \$500. Based on Staff's review it was determined that this expense represents a fine that was assessed during 1990. Staff is of the opinion that this expense is non-recurring and should be excluded for rate-making purposes. Therefore, an adjustment has been made to decrease miscellaneous expense to a level of \$-0-.

Depreciation Expense

4-Way's test-year operations reflect depreciation expense of \$2,342. An adjustment was proposed to increase this expense by \$69 to reflect additions incurred subsequent to 1990. Staff has reviewed 4-Way's depreciation schedule as of December 31, 1991, and has determined that this adjustment meets the rate-making criteria of being known and measurable. Accordingly, test-year depreciation expense has been increased to a level of \$2,411.

Rate Case Expense

In its application 4-Way proposed an adjustment to amortize rate case expense of \$2,500 over a period of 3 years resulting in an annual expense of \$833. These expenses include accounting fees of \$1,000 and legal fees of \$1,500. Staff has reviewed the invoices supporting these fees and is of the opinion that they represent known and measurable expenses. Staff concurs with the 3-year amortization period and therefore, recommends the inclusion of annual rate case expense of \$833 in the determination of 4-Way's revenue requirement.

Operations Summary

Based on the recommendations of Staff contained in this report, 4-Way's operating statement would appear as follows:

	<u>Test Year Actual</u>	<u>Recommended Adjustments</u>	<u>Test Year Adjusted</u>
Operating Revenues:	\$ 53,319	\$ 656	\$ 53,975
Operating Expenses:			
Owner/Management Fee	\$ 4,500	\$ < 2,100 >	\$ 2,400
Sludge Hauling	1,820		1,820
Purchased Water	2,120		2,120
Testing	2,300	100	2,400
Purchased Power	9,619	40	9,659
Chemicals	771		771
Routine Maintenance Fee	4,800	600	5,400
Maintenance-Collection Sys.	1,057		1,057
Maintenance-Plant	13,510		13,510
Agency Collection Fee	7,998	98	8,096
Office Supplies & Other	39		39
Outside Services	1,189		1,189
Insurance	1,791	< 599 >	1,192
Miscellaneous Expense	500	< 500 >	-0-
Depreciation Expense	2,342	69	2,411
Taxes other than Income	875		875
Rate Case Expense	-0-	833	833
Total Operating Expenses	<u>\$ 55,231</u>	<u>\$ < 1,459 ></u>	<u>\$ 53,772</u>
Operating Income	\$ < 1,912 >	\$ 2,115	\$ 203

Revenue Requirements Determination

The approach generally used by this Commission to determine revenue requirements for small, privately-owned utilities is the operating ratio. Staff's adjusted operations provide 4-Way with an operating ratio of 99.6³ percent. 4-Way's proposed increase of \$10,686 would generate an operating ratio of 83⁴ percent. Staff is of the opinion that an 88 percent operating ratio would allow 4-Way sufficient revenues to cover its operating expenses and to provide for reasonable equity growth. Based on an operating ratio of 88 percent, Staff has determined 4-Way's revenue requirement to be \$61,105.⁵ Therefore, Staff recommends that 4-Way be allowed to increase its annual operating revenues by \$7,130.⁶

C. Rate Design

In its application, 4-Way filed a schedule of present and proposed rates and did not propose any changes in the rate structure. The Staff is in agreement that the present rate structure should not be altered. Therefore, any increase granted

³ $\$53,772 + \$53,975 = .996$

⁴ $\$53,772 + (\$53,975 + \$10,686) = .83$

⁵ $\$53,772 + .88 = \$61,105$

⁶

Revenue Requirement	\$61,105
Less: Normalized Test Year Revenues	<u>53,975</u>
Required Increase	\$ 7,130

in the case has been added to the existing rate structure. The rates set forth in Appendix A will produce the recommended revenue requirement. The Staff recommends that those rates be approved for service rendered.

D. Other Issues

In its application 4-Way did not include interest expense as an item to be recovered through operating revenues generated by rates. However, a review of the 1990 annual report reflects accrued interest on long-term obligations to 4-Way Enterprises, Inc. Development Account in the amount of \$14,746. A review of annual reports from prior years indicates that this debt has been accumulating for several years. Staff has determined that these funds were borrowed to allow 4-Way to meet its operating expenses and make necessary capital expenditures when operating revenues were not sufficient. The Commission has previously held that a utility is responsible for seeking a rate increase as additional funds are needed and that recovery of operating expenses incurred in prior years constitutes retroactive rate-making and is prohibited. Therefore, Staff advises that if 4-Way, in the future, finds itself in a financial position where reasonable, legitimate expenses cannot be met, the appropriate response is to petition this Commission for an increase in rates.

E. Signatures

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APPENDIX A
TO STAFF REPORT CASE NO. 91-394

The Staff recommends the following rate be prescribed for customers of 4-Way Enterprises Inc.

<u>Customer Class</u>	<u>Rates</u>
Residential	\$18.10