

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

JACOB CARL KEY	)	
COMPLAINANT	)	
VS.	)	CASE NO. 92-187
TOWN AND COUNTRY WATER DISTRICT	)	
DEFENDANT	)	

O R D E R

On April 14, 1992, Jacob Carl Key filed a formal complaint alleging that the current rates of Town and Country Water District ("Town and Country") are unreasonable. Commission Staff, having performed a limited financial review of Town and Country's operations, has prepared the attached Staff Report containing Staff's findings and recommendations regarding the current 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 8th day of September, 1992.

PUBLIC SERVICE COMMISSION

  
For the Commission

ATTEST:

  
Executive Director

COMMONWEALTH OF KENTUCKY  
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In the Matter of:

JACOB CARL KEY

COMPLAINANT

VS.

TOWN AND COUNTRY WATER DISTRICT

DEFENDANT

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STAFF REPORT

Prepared By: Jack Scott Lawless, CPA  
Public Utility Financial Analyst  
Water and Sewer Revenue Requirements  
Branch, Rates and Tariffs Division

Prepared By: George Steinmetz  
Public Utility Rate Analyst  
Communications, Water and Sewer  
Rate Design Branch  
Research Division

STAFF REPORT  
ON  
TOWN AND COUNTRY WATER DISTRICT  
CASE NO. 92-187

A. Preface

On April 14, 1992, Mr. Jacob Carl Key filed a formal complaint against Mr. Billy Goley alleging that the current rates of Town and Country Water District ("Town and Country") are unreasonable. Mr. Goley is the sole proprietor of Town and Country which is an investor owned utility and is not a water district as its name would indicate. Pursuant to the Order dated August 12, 1992 issued by the Public Service Commission ("Commission"), the Commission Staff ("Staff") is issuing this report to address the complaint.

In order to evaluate the current rates of Town and Country, Staff chose to perform a limited financial review of its operations for the test year ended December 31, 1991 which are reflected in the current annual report on file with the Commission. Jack Scott Lawless, CPA of the Commission's Division of Rates and Tariffs and George Steinmetz of the Commission's Research Division conducted the review on July 13, 1992 at the office of Don Horton, CPA in Russellville, Kentucky.

The findings of the field review have been reduced to writing in this report. Mr. Steinmetz is responsible for the sections related to operating revenues and rate design. The remaining sections of the report were prepared by Mr. Lawless. Based on the findings of this report, Staff is of the opinion that the current

rates and charges of Town and Country produce revenues that are fair, just and reasonable. However, Staff is of the opinion that the rate blocks of Town and Country should be restructured in order to reduce its minimum bill, passing more costs of operations to high usage customers and less costs of operations to low usage customers.

### Scope

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

During the course of the review, Staff identified pro forma adjustments to test year operations that were known and measurable as well as fair, just and reasonable. Adjustments that met these parameters were included in the determination of revenue requirements.

### B. Determination of Adjusted Test Period Operations Operating Revenue

In its 1991 annual report, Town and Country reported test year revenue in the amount of \$27,783.

As part of its review of Town and Country, Staff prepared a billing analysis for the test period. Based on the information obtained on the field review, Staff concludes that total pro forma operating revenues from water sales for 1991 were \$27,245.

Additionally, Staff concludes that normalized revenue from the present rates based on Staff's billing analysis amounts to \$30,704 on an annual basis when factoring in the pass through of cost from the City of Russellville.

#### Operating Expenses

For the test year Town and Country reported operating expenses of \$17,904. Staff has adjusted these expenses to reflect pro forma operations. The pro forma adjustments to test period expenses are discussed in the following sections of this report.

#### Purchased Water

Town and Country reported purchased water expense of \$13,649. Staff has adjusted this amount by \$2,134<sup>1</sup> to reflect the current rates being charged by Town and Country's supplier, the City of Russellville. Staff has also made an adjustment to reflect a 15 percent water loss percentage which is the maximum allowable by this Commission. This adjustment was necessary due to the high rate of water loss experienced by Town and Country. In its annual report Town and Country calculates a 17 percent water loss. However, for this adjustment Staff has calculated a 29.68 percent<sup>2</sup>

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<sup>1</sup>	Normalized expense due to PWA	\$ 15,783
	Less: Test year	<u>(13,649)</u>
	Adjustment	<u>\$ 2,134</u>
<sup>2</sup>	Water purchased (1,000 gallons)	6,810
	Less: Usage from billing analysis	<u>(4,789)</u>
	Unaccounted for Water	2,021
	Divide by: Water purchased	<u>6,810</u>

water loss by utilizing the gallons sold by Town and Country per Staff's billing analysis and the water purchased from the City of Russellville per the City of Russellville's invoices. The resulting adjustment was a decrease in operating expenses of \$2,621<sup>3</sup>.

Owner/Manager fee

Staff is of the opinion that Town and Country is entitled to an owner/manager fee and that \$2,400 would be a reasonable fee for a utility of Town and Country's size. This fee serves as compensation to owners who manage utilities without charging an administrative salary. A fee of this nature is generally allowed by this Commission. Accordingly, operation and maintenance expenses have been increased \$2,400.

Meter Reading and Billing

Mr. Goley, the owner and operator of Town and Country, reads customer meters once a month and prepares the monthly customer billings. However, he does not charge Town and Country for the expenses associated with his time, the deterioration of his equipment or miscellaneous items. Mr. Goley's customers derive a benefit from the meter reading and billing services with which they

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Percentage of water loss	<u>29.68%</u>
<sup>3</sup> Pro forma allowing 15% line loss	\$ 13,162
Less: Pro forma normalized for PWA	<u>(15,783)</u>
Adjustment	<u>\$ (2,621)</u>

are provided; therefore, the costs of those services should be reflected in the rates charged by Town and Country.

To determine what amount would be a fair, just and reasonable charge for such services, Staff contacted the City of Russellville in Logan County, which is Town and Country's water supplier. Although meter reading and billing services from water suppliers are sometimes done, Staff discovered that the City of Russellville does not offer these services to its clients. However, the City Attorney provided Staff with an estimate of \$1.50 per meter per month based only on man hours. This estimate was by no means the amount that the City of Russellville would charge Town and Country to provide such services.

Staff was notified that the City of Adairville, which supplies water to South Logan Water District, provides these services to its wholesale customers. After discussion with Becky Tinch of the City of Adairville, Staff was informed that South Logan Water District is charged \$2.25 per meter per month for meter reading and billing services. There is no profit in the \$2.25 fee; it is based on costs only. Therefore, Staff is of the opinion that \$2.25 per meter per month is a fair, just and reasonable charge. Staff has

adjusted test year operation and maintenance expenses by \$2,700<sup>4</sup> to reflect this pro forma expense so that the reported operating expenses would reflect the cost associated with meter reading and customer billing.

Water Testing

Town and Country is subject to water quality guidelines set out by the Kentucky Division of Water ("DOW"). This will require Town and Country to employ an independent certified commercial laboratory to perform water testing, the results of which will be submitted to the DOW. Prior to and during the test year, Town and Country was not aware of the guidelines imposed by the DOW; therefore, Town and Country's test year expenses did not reflect this annual expense. To determine the pro forma expense associated with water testing services Staff contacted Mr. Doug Wolfe of McCoy & McCoy, Inc. which is an independent certified commercial laboratory. Mr. Wolfe advised Staff that water testing services

<sup>4</sup>	Number of meters	100
	Cost per month per meter	<u>\$ 2.25</u>
	Monthly expense	225
	Annualize	<u>12</u>
	Pro forma	2,700
	Less: Test year	<u>(0)</u>
	Adjustment	<u>\$ 2,700</u>



would cost \$125 per month. Accordingly, Staff has adjusted operation and maintenance expenses by \$1,500<sup>5</sup>.

C. Revenue Requirements

The approach frequently used by this Commission to determine revenue requirements for small, privately owned utilities is the operating ratio. The Commission believes that this approach will allow for the recovery of operating expenses as well as provide for equity growth. Staff is of the opinion that an 88 percent operating ratio plus a dollar for dollar recovery of interest on outstanding debt should be used for determining Town and Country's revenue requirements. To apply this approach, Staff divided the pro forma operating expenses of \$24,017, as shown in Appendix B, by 88 percent, the result of which was added to interest expense which produced a total revenue requirement of \$30,769<sup>6</sup>. This revenue requirement is very similar to the normalized revenues based on Staff's billing analysis of \$30,704. Therefore, it is the opinion

<sup>5</sup>	Monthly testing fee	\$ 125
	Annualize	<u>12</u>
	Pro forma	1,500
	Less: Test year	<u>(0)</u>
	Adjustment	<u>\$ 1,500</u>
<sup>6</sup>	Operating expenses	\$ 24,017
	Divide by: Operating ratio	<u>88%</u>
	Revenue allowable from operating ratio	27,292
	Plus: Interest expense	<u>3,477</u>
	Total Revenue Requirement	<u>\$ 30,769</u>

of Staff that Town and Country is not collecting revenues in excess of revenue requirements.

Furthermore, it is the opinion of Staff that a utility should be on a stand alone basis so that it could still operate and maintain financial stability in the absence of its owner. This is not the case where Town and Country is concerned. On the contrary, it is the opinion of Staff that Town and Country is subsidized by Mr. Goley. An example of this was discovered when meter reading, customer billings and routine maintenance expenses were analyzed. These expenses were incurred by Mr. Goley but never charged to Town and Country. This does not mean that these expenses should be ignored when determining revenue requirements. Although Staff was able to utilize alternative sources to determine a fair, just and reasonable expense for meter reading and customer billings to be included in revenue requirements, the same could not be accomplished for routine maintenance expenses. However, it is evident that subsidization by Mr. Goley is present.

D. Rate Design

In his complaint Jacob Carl Key mentions the fact that the customers of Town and Country have to pay twice as much per minimum bill as the surrounding water utilities. This can't be the overriding concern in setting rates because the cost to provide service may vary significantly between different utilities.

In this case a simple approach appropriate for small water utilities was adhered to. First, the commodity costs between the

first and second rate blocks were allocated based on the percentage of the volume of water sold in each block. Secondly, demand costs were allocated between the first and second blocks based on the volume of water sold in each block but giving twice the weight to water sales in the first block. This assumes that water sales in the second block have a peaking factor of one half that of water sales in the first block, assuming a more uniform usage of water at higher use levels.

Commodity and demand costs allocated to each rate block are then divided by total water sales in each block to produce the block rate for each block.

Therefore, Staff has developed rates that will produce revenue required to meet operating expenses as set out in Appendix A attached to this report.

E. Other Comments and Recommendations

Pursuant to KRS 74.361 the General Assembly of the Commonwealth of Kentucky determined that the merger of water districts was in the public interest as it will tend to eliminate wasteful duplication of costs, improve management and result in greater economies, less cost and a higher degree of service. Staff has discussed the possibility of an acquisition of Town and Country by the City of Russellville with both Mr. Goley and Ms. Peggie Jenkins, City Clerk Treasurer of the City of Russellville. All parties involved invited the opportunity to discuss the combining of the two systems. However, no definite plans have been initiated

to date. Although, the parties involved are not water districts as discussed in KRS 74.361, the same benefits of a merger or acquisition could be derived by the customers of Town and Country, and Staff would encourage the parties to explore the possibility.

F. Signatures

Jack Scott Lawless CPA  
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Public Utility Financial Analyst  
Water and Sewer Revenue Requirements  
Branch, Division of Rates and Tariffs

George R. Steinmetz  
Prepared By: George Steinmetz  
Public Utility Rate Analyst  
Communications, Water and Sewer  
Rate Design Branch  
Research Division

APPENDIX A

TO STAFF REPORT CASE NO. 92-187

The Staff recommends the following rates be prescribed for customers of Billy Goley d/b/a Town and Country Water District.

Rates: Monthly

5/8 x 3/4

First 2,000 gallons - Minimum bill	\$ 16.40
All over 2,000 gallons (per 1,000 gallons)	4.50

# APPENDIX B

TO STAFF REPORT CASE NO. 92-187

## Town and Country Water District Statement of Adjusted Operations

	Test Year	Adjustments	Adjusted Test Year
Sales of water	\$27,783	\$2,921	\$30,704
Operating expenses			
Operation and Maintenance			
Purchased water	13,649	2,134	13,162
Insurance	263	(2,621)	263
Miscellaneous	646		646
Owner manager fee		2,400	2,400
Meter reading and billing		2,700	2,700
Testing fee		1,500	1,500
Total Operation and Maintenance	14,558	6,113	20,671
Depreciation	3,346		3,346
Total Operating Expenses	17,904	6,113	24,017
Net Operating Income	\$9,879	(\$3,192)	\$6,687