

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF POTTER WATER SERVICE)
FOR AN ADJUSTMENT OF RATES PURSUANT)
TO THE ALTERNATIVE RATE FILING) CASE NO. 95-272
PROCEDURE FOR SMALL UTILITIES)

O R D E R

On June 21, 1995, Potter Water Service ("Potter Water") filed its application for Commission approval of proposed water rates. Commission Staff, having performed a limited financial review of Potter Water'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 no more than 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, this case will be submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this 25th day of August, 1995.

ATTEST:


Executive Director

PUBLIC SERVICE COMMISSION


For the Commission

COMMONWEALTH OF KENTUCKY
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THE APPLICATION OF POTTER WATER SERVICE)
FOR A RATE ADJUSTMENT PURSUANT TO THE)
ALTERNATIVE RATE FILING PROCEDURE FOR) CASE NO. 95-272
SMALL UTILITIES)

STAFF REPORT

Prepared By: Carl Salyer Combs
Public Utility Financial
Analyst, Senior
Water and Sewer Revenue
Requirements Branch
Financial Analysis Division

Prepared By: John Geoghegan
Public Utility Rate
Analyst, Chief
Communications, Water and
Sewer Rate Design Branch
Rates and Research Division

STAFF REPORT
ON
POTTER WATER SERVICE
CASE NO. 95-272

A. Preface

On June 21, 1995, Potter Water Service ("Potter Water") filed an application with the Commission seeking to increase its water rates pursuant to the Alternative Rate Filing Procedure for Small Utilities. The proposed rates would generate approximately \$3,732 annually in additional revenues, an increase of 13.1 percent over normalized test-year revenues of \$28,513.

In order to evaluate the requested increase, the Commission Staff ("Staff") chose to perform a limited financial review of Potter Water's operations for the test period, calendar year 1994. Since Potter Water requested and received Staff assistance in preparing this application, the field review was done prior to the filing of the application. Carl Salyer Combs conducted the review on May 22-23, 1995, at the home of Roy C. Potter, the owner of Potter Water. Mr. Combs is responsible for this Staff Report except for the sections on operating revenues and rate design which were prepared by John Geoghegan of the Commission's Division of Rates and Research.

During the course of the review, Potter Water was informed that all proposed adjustments to test-year expenses must be supported by some form of documentation, such as an invoice, or

that all such adjustments must be known and measurable. Based upon the findings of this report, Staff recommends that Potter Water be authorized to increase its annual operating revenues by \$3,661 over normalized revenues of \$28,513.

Scope

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

B. Analysis of Operating Revenues and Expenses

Operating Revenues

Staff performed a billing analysis for Potter which indicated its test period revenue from rates was \$28,513 requiring an adjustment of \$839 over Potter's reported test year revenue from rates of \$27,674.

Operating Expenses

Potter Water reported test-period operating expenses of \$29,249 which it proposed to increase by \$3,781. Staff's recommendations on Potter Water's proposed adjustments are discussed in the following sections:

Management Fee

Potter Water reported no test-year management fee, but proposed an annual fee of \$2,400. The Commission's normal practice in cases involving small water utilities is to allow an annual management fee of \$2,400 and Staff is of the opinion that such an

amount is appropriate in this instance. Therefore, Staff recommends inclusion of an annual management fee of \$2,400 for rate-making purposes.

Contractual Services

Potter Water reported test-year legal and accounting expense of \$1,075, engineering services expense of \$2,948, water analysis expense of \$1,001, and an annual expense of \$1,200 for a certified operator. Staff recommends that all of these expenses be reclassified into Account No. 630 - Contractual Services.

With regard to legal and accounting expense of \$1,075, Potter Water paid \$500 in legal fees related to Case No. 94-434¹ during the test year. The Commission's normal practice is to amortize such fees over a three-year period. Staff recommends that the \$500 in legal fees be excluded from contractual services expense. This expense will be discussed further in a section on amortization expense. The remaining \$575, composed entirely of accounting fees, has been included in contractual services expense for rate-making purposes.

With regard to engineering services expense of \$2,948, Potter Water stated that the fees were paid for work related to a slow sand filtration system required by the Environmental Protection Agency. According to Potter Water, this expense is of a non-recurring nature and Staff recommends that it be excluded from this account for rate-making purposes. This expense will be discussed

¹ The Joint Application of Potter Water Service and Mountain Water District for the Transfer of Residential Water Service, Order Dated May 31, 1995

further in a section on amortization expense.

Potter Water proposed to increase reported test-year water analysis expense of \$1,001 by \$1,381 due to more stringent requirements by the Kentucky Natural Resources and Environmental Protection Cabinet for water testing. Staff's review of the supporting documents determined that the increase to the test-year amount should be \$1,390. Bob Arnett of the Commission's Engineering Division reviewed the documentation provided by Potter Water and is of the opinion that the proposed adjustment is reasonable. Therefore, Staff recommends that annual water analysis expense of \$2,391 be included for rate-making purposes.

Altogether, Staff recommends that annual contractual services expense of \$4,166² be included for rate-making purposes.

Miscellaneous Expense

Potter Water reported test-year miscellaneous expense of \$9,896. As mentioned previously in the section on contractual services expense, Staff recommends reclassification to the contractual services account of the following: legal and accounting expense of \$1,075; engineering services expense of \$2,948; water analysis expense of \$1,001; and an annual fee of \$1,200 for a certified operator. These expenses total \$6,244 and Staff recommends inclusion of annual miscellaneous expense of \$3,672 for rate-making purposes.

² Accounting Expense	\$ 575
Water Analysis	2,391
Certified Operator	<u>1,200</u>
Total Expense	<u>\$ 4,166</u>

Depreciation Expense

Potter Water reported test-year depreciation expense of \$5,372. Of that amount, \$2,035 was related to depreciation on non-utility property. Staff recommends that depreciation expense related to the non-utility property be excluded and that annual depreciation expense of \$3,337 be included for rate-making purposes.

Amortization Expense

Potter Water reported no test-year amortization expense. As mentioned previously in the section on contractual services, legal expense of \$500 was incurred during the test year for services related to another case. Since the Commission's normal practice is to amortize such an expense over a three-year period, Staff recommends that treatment in this instance and has included annual amortization expense of \$167, related to legal services, for rate-making purposes.

As mentioned previously in the section on contractual services, Potter Water also incurred engineering services expense of \$2,948 during the test year. The Commission normally allows amortization of such an expense over a five-year period. Staff is of the opinion that such treatment is appropriate in this instance and has included annual amortization expense of \$590, related to engineering services, for rate-making purposes.

Altogether, Staff recommends that annual amortization expense of \$757 be included for rate-making purposes.

Operations Summary

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

	<u>Test Period</u> <u>Application</u>	<u>Recommended</u> <u>Adjustments</u>	<u>Test Year</u> <u>Adjusted</u>
OPERATING REVENUES	\$ 27,674	\$ 839	\$ 28,513
OPERATING EXPENSES:			
Salaries and Wages	\$ 7,688	\$ -0-	\$ 7,688
Management Fee	-0-	2,400	2,400
Chemicals	157	-0-	157
Materials & Supplies	2,091	-0-	2,091
Contractual Services	-0-	4,166	4,166
Transportation	921	-0-	921
Insurance	2,309	-0-	2,309
Miscellaneous	9,896	(6,224)	3,672
Depreciation	5,372	(2,035)	3,337
Amortization	-0-	757	757
Taxes Other Than Inc.	815	-0-	815
Total Operating Exp.	<u>\$ 29,249</u>	<u>\$ (936)</u>	<u>\$ 28,313</u>
NET INCOME	<u>\$ (1,575)</u>	<u>\$ 1,775</u>	<u>\$ 200</u>

C. Revenue Requirements Determination

The approach frequently used by the Commission to determine revenue requirements for small, privately-owned utilities is the calculation of an operating ratio.¹

This approach is used primarily when there is no basis for a rate-of-return determination or due to the fact that the cost of the utility plant has been recovered fully, or largely, through the receipt of contributions, either in the form of grants or donated property. As Potter Water fits this description, Staff recommends use of an operating ratio for determining revenue requirements. The ratio generally used by the Commission in order to provide for

¹ Operating ratio = operating expense/operating revenue

equity growth is 88 percent. In this instance, use of an 88 percent operating ratio applied to the adjusted test-year operating expense results in a total revenue requirement of \$32,174 and an increase of \$3,661⁴ in annual revenues.

D. Rate Design

Potter's current rates consist of a two-step rate design for residential customers with a minimum bill for the first 2,000 gallons and a rate for each 1,000 gallons over 2,000. It also has a Small Bottling rate for its only commercial customer, Mother Nature Mountain Spring Water ("Mother Nature"), and a rate for Large Bottling which Mother Nature or any other water bottling customer can use by entering into a 12-month contract with Potter as established in Case No. 92-540 by Order dated June 18, 1993.

Staff agrees with Potter's current rate design and recommends that any additional revenue needed be added to the existing rate structure. The rates set out in Appendix A will generate \$32,245 in annual revenue from rates, an adequate amount to cover Potter's annual expenses.

⁴ Adjusted Operating Expense/Operating Ratio	\$ 28,313/.88
Revenue Requirement	\$ 32,174
Less: Normalized Test-Year Revenue	(28,513)
Amount of Increase Required	<u>\$ 3,661</u>

E. Signatures

Carl Salyer Combs

Prepared By: Carl Salyer Combs
Public Utility Financial
Analyst, Senior
Water and Sewer Revenue
Requirements Branch
Financial Analysis Division

John Geoghegan

Prepared By: John Geoghegan
Public Utility Rate Analyst
Communications, Water and
Sewer Rate Design Branch
Rates and Research Division

**APPENDIX A
ROY POTTER WATER SERVICE**

The following rates are recommended for customers of the Roy Potter Water Service.

Monthly Residential Rate:

First 2,000 gallons	\$ 20.48 minimum bill
Over 2,000 gallons	2.40 per 1,000 gallons

Monthly Commercial Rate:

Small Bottling Rate

First 60,000 gallons	\$ 779.00 minimum bill
Over 60,000 gallons	13.55 per 1,000 gallons

Large Bottling Rate

First 225,000 gallons	\$2,413.24 minimum bill
Over 225,000 gallons	10.16 per 1,000 gallons