

COMMONWEALTH OF KENTUCKY  
BEFORE THE UTILITY REGULATORY COMMISSION

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In the Matter of

AN ADJUSTMENT OF RATES JOINTLY )  
OF THE SPEARS WATER DISTRICT )  
AND THE SPEARS WATER COMPANY, ) CASE NO. 7657  
INCORPORATED )

O R D E R

On March 6, 1980, Spears Water District and Spears Water Company (hereinafter referred to on an individual basis as the District and the Company, and on a joint basis as the Applicants) jointly filed with this Commission a duly verified petition seeking an adjustment in water rates based on an increase by their water supplier, the City of Nicholasville, from \$.30 per thousand gallons to \$.55 per thousand gallons effective January 1, 1980. Further, the District filed a proposal seeking permission to eliminate mobile home and field rates, whereby, the entire water service area of the two systems would be covered by a single rate structure. These proposed adjustments will increase the annual revenues of the District and the Company by approximately \$68,011 and \$19,287, respectively.

The matter was set for hearing at the Commission's offices in Frankfort, Kentucky, on May 12, 1980, at 10:00 a.m. All parties of interest were notified with the Consumer Intervention Division of the Attorney General's Office being the only party to intervene in the matter. At the hearing, certain requests for additional information were made by the Commission Staff. This information was filed, and the entire matter is now considered to be fully submitted for final determination by this Commission.

TEST PERIOD

The twelve (12) month period ending December 31, 1979, was used by both the District and the Company as the test period for purposes of testing the reasonableness of existing and proposed

rates. Schedules of revenues and expenses including proforma adjustments to the actual test period results were submitted to the Commission for consideration. This test period met the requirements of the administrative regulations of the Commission and was accepted as filed.

#### COMMENTARY

The District and the Company have filed several motions in the past few years which may be relevant to certain findings in this matter. Following is a chronological description of major cases filed and the findings of the Commission (Public Service Commission prior to April 1, 1979) on each:

##### Case No. 5747

On October 3, 1972, a joint application was filed by the District and the Company seeking approval of a lease and sale of properties of the District to the Company. On December 20, 1972, the Commission issued an order denying approval of the application. On January 8, 1973, Applicants filed for a rehearing and on April 5, 1973, the motion was again denied. The matter was appealed to the Franklin Circuit Court in Civil Action #84062 on May 9, 1973. The Court affirmed the Commission in its order of June 24, 1975.

##### Case No. 6464

On January 14, 1976, a joint application was filed by the District and the Company seeking approval of a lease purchase agreement. On March 15, 1976, the Commission issued an order approving the joint application. On March 24, 1976, the Applicants advised the Commission that the Company would commence operating the District on April 1, 1976.

##### Case No. 6964

On December 8, 1977, a joint application was filed by the City of Nicholasville and the Company seeking approval of the sale and purchase of water service facilities (formerly Jessamine County Water District #3). On December 29, 1977, the Commission issued an order approving the joint application.

Other important dates are as follows:

April 19, 1979

A meeting was held among the Commission Staff, the District and the Company to discuss the merits of keeping the financial records independent from one another and the need to refile the 1976, 1977, and 1978 Annual Reports to the Commission showing the results of operations for each entity.

June 22, 1979

A letter was issued by the Commission Staff acknowledging receipt of the refiled 1976, 1977, and 1978 Annual Reports and emphasizing the need to keep the financial records independent until such time as the Company actually purchased the District pursuant to the lease purchase agreement approved in Case No. 6464.

July 16, 1979

An audit was performed by the Commission Staff to segregate the financial records of the District and the Company.

REVENUES AND EXPENSES

The financial records of the District and the Company were maintained on a combined basis for a portion of the test period. In the preparation of year-end financial statements and information submitted for consideration in the instant matter, revenues and expenses, where possible, were directly assigned to the District and Company. However, common revenues and expenses were generally assigned on a pro rata basis between the two utilities.

The existing rates charged by the District and the Company during the test period produced annual revenues from water sales of \$159,276 and \$36,069, respectively, and including penalties and service charges, gross operating revenues of \$160,950 and \$37,072, respectively. No proforma adjustments for changes in the number of customers or usage were submitted in the Petition.

The operating expenses, for the District and the Company as submitted for the test period were \$122,877 and \$33,439, respectively. Several proforma adjustments were proposed in the

Petition to reflect more current operating conditions. These proposed adjustments were found to be similar in nature for both the District and the Company. Therefore, the Commission has given equal consideration to these adjustments and is of the opinion that the adjustments generally are proper and have been accepted with the following exceptions:

1. The District and the Company proposed an adjustment in purchased water expense of \$19,163 and \$3,633, respectively, to reflect increased costs from their principal supplier. However, the record in this matter showed that unaccounted for water was excessive and did not reflect adequate accountability for purchased water. Unaccounted for water was nearly 40% for the District and 16% for the Company. The Applicants included some allowance for unaccounted for water, but the methodology used in the determination of the allowance was found to be improper. The Commission determined that the cost of water would be increased by \$11,073 for the District and \$5,147 for the Company over the test period costs. These adjustments were determined by using test period water sales in gallons including a maximum allowance of 15% for unaccounted for water. Also, two other minor changes were made to the proposed adjustment to reflect more accurately the cost of purchased water. These changes were the use of \$.57 rather than \$.55 per thousand gallons by the District to reflect the higher costs of water from a second supplier of the District and a reduction in the water sales of the Company to remove from sales an overstatement of 855,500 gallons<sup>1</sup> which resulted from an incorrect reading of a customer's meter during the month of April.

2. In reviewing the record of this matter, the Commission found that the operating expenses with respect to Operation Labor of the Company for the test period included \$3,856 as part of a final payment of an invoice dated October 30, 1978.<sup>2</sup> This amount

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<sup>1</sup>Exhibits filed May 28, 1980, with reference to Credit Adjustments.

<sup>2</sup>Exhibits filed May 19, 1980, with reference to statement of E. H. Stephenson.

had been incurred to expand the utility plant. It should have been capitalized, and for this reason, it has been excluded from test year operating expenses.

3. During the summer of 1979, Commission Staff performed an audit on the two systems to segregate the financial records for the years 1976, 1977, and 1978. Subsequent to completion of this audit, the two systems filed amended tax returns for this three-year period and revised the current financial statements to incorporate the findings of the Commission Staff. The fees totaling \$2,318<sup>3</sup> for this service were found to be extraordinary and have been excluded on a 50/50 basis from the consideration in this matter.

4. Legal fees<sup>4</sup> shown as operating expenses by the two systems during the test period were primarily for this matter and a second matter before the Commission involving only the Company. All of these fees were prorated between the two utilities, but the Commission's review of these fees disclosed that fees in the amount of \$505 were directly associated with the Company.<sup>5</sup> In the opinion of the Commission, fees of this nature should be amortized and expensed over a period of at least three years. Only that portion of legal fees relevant to the test period has been included for consideration in this matter.

5. Shortly after the Company began operating the District on April 1, 1976, the stockholders of the Company purchased whole life insurance policies to protect the Company upon the death of any of the stockholders. These policies were designed to fund a stock redemption agreement between the stockholders and the Company. The Company was made the beneficiary of all policies. The text of Account 426, Miscellaneous Income Deductions, of the Uniform System of Accounts for Class C Water Utilities, provides

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<sup>3</sup>Exhibits filed May 28, 1980, with reference to question one (1).

<sup>4</sup>Exhibits filed May 28, 1980, with reference to statement of William Arvin.

<sup>5</sup>Of this amount, \$408 was erroneously prorated to the District.

that life insurance of officers and employees where the utility is beneficiary is considered to be nonoperating in nature. In the opinion of the Commission, the annual premium of \$7,226 for these insurance policies should not be included in the consideration of this matter, but should be borne by the stockholders of the Company. Further, the Commission found that a substantial portion of these premiums (\$5,364) had inappropriately been shown as operating expenses of the District during the test period. These life insurance premiums have been excluded from the test period operating expenses submitted for consideration in this matter.

6. A number of proforma adjustments were proposed for operating expenses based on the use of arbitrary percentage changes which were not substantiated by evidence submitted in this matter and have been excluded from the consideration thereof.

Based on the foregoing discussion, the proforma annual level of operating expenses found reasonable for the District and the Company were \$131,461 and \$33,934, respectively.

#### SUMMARY

The Commission, after careful consideration of the evidence of record and being advised, is of the opinion and so finds:

1. That the District and the Company should establish and maintain a program of water loss detection and correction which would substantially reduce and control unaccounted for water.

2. That the District should, as required by Section 5 of the Waterworks Revenue Bond Ordinance, deposit from the first revenues of each month a sum of \$2,425 in the Bond Account. Of the revenues remaining, revenue sufficient to pay the reasonable current expenses should be deposited to the Operation and Maintenance Account; \$235 should be deposited to the Depreciation Account until the cumulative deposits total \$42,000; and any remaining revenues should be deposited to the Bond Reserve Account or the Surplus Account with the Bond Reserve Account requiring

deposits of \$42,000 before any revenues may be deposited to the Surplus Account.

3. That the District should as required by Section 12 of the Waterworks Revenue Bond Ordinance be audited within sixty (60) days after the close of each fiscal year by an independent firm of certified public accountants. Further, that it may be in the best interest of the Company to consider implementation of a policy analogous to that required of the District.

4. That the schedule of rates prescribed and set forth in Appendix "A," attached hereto and made a part hereof, are the fair, just and reasonable rates to charge for water service rendered by the Spears Water District, in that, based on test period conditions, these rates will produce annual revenues of \$159,480, including penalties and service charges of \$1,674 and that these rates are the same as those currently prescribed.

5. That the revenues of \$159,480 are necessary and will permit the District to meet its reasonable operating expenses, service its debt, and to accumulate a reasonable surplus for compliance with its bond ordinance requirements. The test period and projected revenues and expenses are summarized in Appendix "B," attached hereto and made a part hereof.

6. That the schedule of rates prescribed and set forth in Appendix "C," attached hereto and made a part hereof, are the fair, just and reasonable rates to charge for water service rendered by the Spears Water Company, Incorporated, in that, based on test period conditions, these rates will produce annual revenues of \$46,704, including penalties and service charges of \$1,003.

7. That the revenues of \$46,704 will allow a rate of return of 11% on Net Original Cost rate base of \$116,093<sup>6</sup> and will permit the Company to meet its reasonable operating expenses,

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<sup>6</sup> Utility Plant In Service	\$130,199 <sup>A</sup>
Plus: Cash Working Capital	3,584 <sup>B</sup>
Less: Accumulated Depreciation	12,710 <sup>A</sup>
Less: Contribution In Aid of Construction	4,980 <sup>A</sup>
Net Original Cost Rate Base	<u>\$116,093</u>

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<sup>A</sup>As shown on the exhibit of the Balance Sheet as of December 31, 1979.

<sup>B</sup>Operating expenses cash flow required for 45 days.

service its debt and to accumulate a reasonable surplus for equity growth. The test period and projected revenues and expenses are summarized in Appendix "D," attached hereto and made a part hereof.

8. That the rates jointly proposed by the District and the Company are unfair, unjust and unreasonable in that these rates would produce revenues in excess of those found reasonable herein and should be denied.

9. That the proposal seeking permission to eliminate mobile home and field rates is unwarranted and should be denied.

#### ORDERS IN THIS MATTER

The Commission, on the basis of the findings hereinbefore set forth, and the evidence of record in this matter:

HEREBY ORDERS that the District and the Company shall furnish the Commission with a plan of water loss detection and correction and that monthly reports shall be furnished until there is a substantial reduction and control in unaccounted for water.

IT IS FURTHER ORDERED, that the District shall implement the procedures prescribed by Section 5 of the Waterworks Revenue Bond Ordinance as briefly described herein.

IT IS FURTHER ORDERED that the District shall implement the procedures prescribed by Section 12 of the Waterworks Revenue Bond Ordinance as briefly described herein.

IT IS FURTHER ORDERED that the schedule of rates set forth in Appendix "A" be and hereby are fixed as the fair, just and reasonable rates to charge for water service rendered by the Spears Water District on and after the date of this Order.

IT IS FURTHER ORDERED that the schedule of rates set forth in Appendix "C" be and hereby are fixed as the fair, just and reasonable rates to charge for water service rendered by the Spears Water Company, Incorporated on and after the date of this Order.

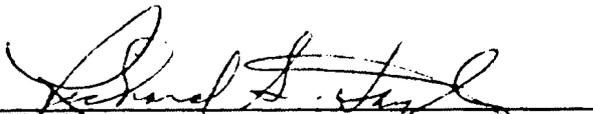
IT IS FURTHER ORDERED that the rates jointly proposed by the District and the Company be and are hereby denied.

IT IS FURTHER ORDERED that the proposal seeking permission to eliminate mobile home and field rates be and is hereby denied.

IT IS FURTHER ORDERED that the District and the Company shall file with this Commission within thirty (30) days from the date of this Order their revised tariff sheets setting out the rates approved herein and their current rules and regulations.

Done at Frankfort, Kentucky, this the 2nd day of July, 1980.

UTILITY REGULATORY COMMISSION

  
Chairman

  
Vice Chairman

  
Commissioner

ATTEST:

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Secretary

APPENDIX "A"

APPENDIX TO AN ORDER OF THE UTILITY REGULATORY COMMISSION  
IN CASE NUMBER 7657, DATED JULY 2, 1980.

The following schedule of rates are hereby prescribed for the customers served by the Spears Water District. All other rates and charges not mentioned specifically herein shall remain the same as those in effect prior to the date of this Order.

RESIDENTIAL SERVICE

<u>Gallage Blocks</u>	<u>Monthly Rates</u>
First 2,000 gallons	\$7.50 (Minimum Bill)
Next 10,000 gallons	2.00 per 1,000 gallons
All over 12,000 gallons	1.00 per 1,000 gallons

MOBILE HOME SERVICE

<u>Gallage Blocks</u>	<u>Monthly Rates</u>
First 1,000 gallons	\$3.00 (Minimum Bill)
All over 1,000 gallons	1.25 per 1,000 gallons

FIELD SERVICE

<u>Gallage Blocks</u>	<u>Monthly Rates</u>
First 1,000 gallons	\$3.50
All over 1,000 gallons	1.00

APPENDIX "B"

APPENDIX TO AN ORDER OF THE UTILITY REGULATORY COMMISSION  
IN CASE NUMBER 7657, DATED JULY 2, 1980.

This is a summary of test period and projected revenues and expenses of the Spears Water District as shown by the evidence submitted in this matter.

	<u>Actual Test Period</u>	<u>Proposed Proforma</u>	<u>Reasonable Proforma</u>
<u>Operating Revenues:</u>			
Water Sales	\$159,276	\$227,287	\$157,806 <sup>B</sup>
Penalties	464	766	464 <sup>B</sup>
Service Charges	<u>1,210</u>	<u>1,452</u>	<u>1,210</u>
Total Operating Revenues	\$160,950	\$229,505	\$159,480 <sup>C</sup>
<u>Operating Expenses:</u>			
Purchased Water	\$ 35,097	\$ 54,260	\$ 46,170
Operation Labor	15,403	19,001	19,001
Maintenance of Mains	575	907	907
Meter Reading	3,096	3,406	3,406
Accounting & Collecting			
Labor	17,736	19,510 <sup>A</sup>	19,510
Supplies & Expenses	6,109	6,720 <sup>A</sup>	6,109
Uncollectible Amounts	64	100 <sup>A</sup>	64
Office Supplies & Expenses	1,171	1,253 <sup>A</sup>	1,171
Property Insurance	308	330 <sup>A</sup>	308
Injuries and Damages	9,488	10,437 <sup>A</sup>	4,124 <sup>D</sup>
Misc. General Expenses	9,812	10,499 <sup>A</sup>	5,994 <sup>E</sup>
Transportation Expenses	1,168	1,460	1,460
Taxes Other Than Income			
Taxes	3,868	4,255	4,255
Depreciation Expense	<u>18,982</u>	<u>18,982</u>	<u>18,982</u>
Total Operating Expenses	\$122,877	\$151,120	\$131,461
Net Operating Income	\$ 38,073	\$ 78,385	\$ 28,019
Interest Expense	\$ 21,945	\$ 21,525	\$ 21,525
Net Income	<u>\$ 16,128</u>	<u>\$ 56,860</u>	<u>\$ 6,494</u>

<sup>A</sup>These proposed proforma amounts were increased over actual based on arbitrary estimates and the subsequent adjustments have been disallowed in determining the reasonable proforma amounts.

<sup>B</sup>Test period amount was reduced \$2,400 as tap-on fees should not be considered operating revenues.

<sup>C</sup>Revenue requirements were determined to be one and one-half times the debt service costs plus reasonable bond ordinance requirements and reasonable operating expenses, excluding depreciation expense.

<sup>D</sup>This amount was reduced by insurance premiums considered non-operating in nature.

<sup>E</sup>This amount was determined as follows: Actual (\$9,812) less that portion of legal fees erroneously prorated to the District (\$408) less legal fees unamortized (\$2,251) and extraordinary accounting fees (\$1,159).

APPENDIX "C"

APPENDIX TO AN ORDER OF THE UTILITY REGULATORY COMMISSION  
IN CASE NUMBER 7657, DATED JULY 2, 1980.

The following schedule of rates are hereby prescribed for the customers served by the Spears Water Company, Incorporated. All other rates and charges not mentioned specifically herein shall remain the same as those in effect prior to the date of this Order.

GALLONAGE BLOCKS

MONTHLY RATES

First 2,000 gallons  
Next 10,000 gallons  
All over 12,000 gallons

\$7.50 (Minimum Bill)  
3.00 per 1,000 gallons  
1.50 per 1,000 gallons

APPENDIX "D"

APPENDIX TO AN ORDER OF THE UTILITY REGULATORY COMMISSION  
IN CASE NUMBER 7657, DATED JULY 2, 1980.

This is a summary of test period and projected revenues and expenses of the Spears Water Company, Incorporated as shown by the evidence submitted in this matter.

	<u>Actual Test Period</u>	<u>Proposed Proforma</u>	<u>Reasonable Proforma</u>
<u>Operating Revenues:</u>			
Water Sales	\$36,069	\$55,356	\$45,701
Penalties	465	697	465
Service Charges	538	629	538
Total Operating Revenues	<u>\$37,072</u>	<u>\$56,682</u>	<u>\$46,704</u>
<u>Operating Expenses:</u>			
Purchased Water	\$ 5,589	\$ 9,222	\$10,736
Operation Labor	7,423	10,482	4,401
Maintenance of Mains	6	200	200
Meter Reading	717	789	789
Accounting and Collecting- Labor	4,106	4,516 <sup>A</sup>	4,516
Supplies and Expenses	406	447 <sup>A</sup>	406
Uncollectible Accounts	138	207 <sup>A</sup>	138
Office Supplies & Expenses	1,129	1,208 <sup>A</sup>	1,129
Outside Services	35	50 <sup>A</sup>	35
Property Insurance	234	257 <sup>A</sup>	234
Injuries and Damages	965	1,062 <sup>A</sup>	965 <sup>B</sup>
Misc. General Expenses	3,035	3,339 <sup>A</sup>	1,428 <sup>B</sup>
Transportation Expenses	521	938	938
Taxes Other Than Income Taxes	1,262	1,388	1,388 <sup>C</sup>
Other Operating Expenses	2,342	2,342	1,100 <sup>C</sup>
Depreciation Expense	5,531	5,531	5,531
Total Operating Expenses	<u>\$33,439</u>	<u>\$41,978</u>	<u>\$33,934</u>
Net Operating Income	<u>\$ 3,633</u>	<u>\$14,704</u>	<u>\$12,770</u>
<u>Other Deductions:</u>			
Interest on Long-Term Debt	\$ 8,196	\$ 6,688	\$ 6,688
Other Interest Expense	145	184	184
Total Other Deductions	<u>\$ 8,341</u>	<u>\$ 6,872</u>	<u>\$ 6,872</u>
Net Income	<u><u>\$(4,708)</u></u>	<u><u>\$ 7,832</u></u>	<u><u>\$ 5,898</u></u>

<sup>A</sup>These proposed proforma amounts were increased over actual based on arbitrary estimates and the subsequent adjustments have been disallowed in determining the reasonable proforma amounts.

<sup>B</sup>This amount was determined as follows: Actual (\$3,035) plus that portion of legal fees erroneously prorated to the District (\$408) less legal fees unamortized (\$856) and extraordinary accounting fees (\$1,159).

<sup>C</sup>This amount was reduced by insurance premiums considered nonoperating in nature.