

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

BEREA COLLEGE WATER UTILITY)
A DEPARTMENT OF BEREA COLLEGE)

CASE NOS. 8531 & 8556

O R D E R

On May 18, 1982, the Berea College Water Utility ("Berea") filed with the Commission an application seeking an interim increase in rates for service rendered on and after June 25, 1982, that would produce additional annual revenue of \$64,100, or an increase of 8.7 percent. On July 1, 1982, Berea filed an amended application in which, among other things, it requested a permanent rate increase in the amount of \$237,700 annually, an increase of 32.2 percent. The interim increase was granted in the Commission's Interim Order of September 1, 1982. Berea stated that the requested permanent rate increase was required to meet the increased costs of operation, particularly the costs related to the improvements to its reservoir dams. Based on the determination herein, Berea has been granted a total increase in revenue, including the interim increase, of \$195,110 annually, or 26.4 percent.

On June 22, 1982, the Commission suspended the proposed interim increase until November 25, 1982. On July 27, 1982, the Commission ordered that the request for a permanent rate increase be consolidated with the requested interim increase and directed

Berea to give notice to its consumers of the proposed rates and the hearing scheduled for September 29, 1982.

On June 7, 1982, the City of Berea ("City") moved to intervene in this proceeding pursuant to KRS 278.260, which motion was granted. On June 9, 1982, the Consumer Protection Division of the Office of the Attorney General moved to intervene in this proceeding pursuant to KRS 367.150(8), which motion was also granted. These were the only parties of interest formally intervening herein. Briefs were filed on November 1, 1982.

COMMENTARY

Berea is a department of Berea College ("College") which is a non-profit educational institution. Berea provides water service to approximately 2,700 customers in and around Berea, Kentucky.

TEST PERIOD

Berea proposed and the Commission has accepted the 12-month period ending March 31, 1982, as the test period for determining the reasonableness of the proposed rates. In utilizing the historic test period, the Commission has given full consideration to appropriate known and measurable changes.

VALUATION

Net Investment

Berea proposed a net investment rate base of \$4,807,011. The Commission concurs with this determination with the following exceptions:

Berea adjusted plant in service to reflect additions to plant subsequent to the test year. The Commission, as a matter of policy, does not generally allow adjustments of this type. However, in

this instance, those additions had been recorded as plant in service and placed in service prior to the evidentiary hearing of this case. Furthermore, due to the magnitude of these additions, failure to include them in the rate base could impair Berea's financial integrity. The Commission will in this instance include additions to plant related to the reservoir improvement project made subsequent to the test year.

The allowance for working capital has been adjusted to include the pro forma level of operating expenses allowed herein. The Commission has further adjusted the proposed rate base to reflect the allowed pro forma adjustment to depreciation expense in the calculation of the accumulated provision for depreciation.

The rate base has been reduced by \$105,000 to reflect, for rate-making purposes, an adjustment to the balance of contributions in aid of construction. During the test year, Berea's equity was increased by \$105,000 to reflect increases in plant in service and construction work in progress related to the reservoir improvement project. These additions to plant were provided through a donation to Berea College which was then transferred to the water utility department. Such additions do not represent additional investment by Berea College on which it should be allowed to earn a return and, therefore, the rate base has been reduced accordingly.

Based on the Commission's adjustments, Berea's net investment rate base for rate-making purposes is as follows:

Utility Plant in Service	\$6,019,656
Add:	
Materials and Supplies	\$ 68,683
Working Capital	45,620
Subtotal	<u>\$ 114,303</u>
Deduct:	
Accumulated Depreciation	\$1,151,418
Customer Advances for Construction	83,176
Contributions in Aid of Construction	144,603
Accumulated Deferred Taxes	58,178
Subtotal	<u>\$1,437,375</u>
Net Investment	<u><u>\$4,696,584</u></u>

Capital Structure

The Commission finds from the evidence of record that Berea's adjusted capital structure for rate-making purposes is \$4,640,379 and consists of \$590,000 in equity, \$3,350,000 in long-term debt, and \$700,379 in short-term debt. In the determination of this capital structure the Commission has included all debt related to the reservoir improvement project while excluding the \$105,000 from equity that was provided through a donation to Berea College.

REVENUES AND EXPENSES

Berea proposed several adjustments to revenues and expenses to reflect more current and anticipated operating conditions. The Commission finds the proposed adjustments are generally proper and acceptable for rate-making purposes with the following exceptions:

Labor Costs

Berea proposed an adjustment of \$18,676 to normalize salaries and wages charged to expense. In determining the pro forma expense Berea estimated that capitalized salaries and wages would be \$12,000

or 7.5 percent of total salaries and wages. Over the last 5 years, Berea has capitalized salaries and wages at a rate equal to 11.7 percent of total salaries and wages. Berea contended that capitalized salaries and wages would decline as a result of the completion of the reservoir construction project and absence of additional major construction in the near future. However, the record in this case and the annual reports Berea has filed with the Commission reveal that its capitalized wages do not consistently increase in proportion to increases in the amount of new plant in service. The Commission is of the opinion that Berea's adjustment results in an overstatement of pro forma salaries and wages expense. Therefore, the proposed adjustment has been reduced by \$6,585 to reflect the historical level of capitalized salaries and wages.

Berea also proposed an adjustment of \$3,258 to reflect increases in payroll taxes and fringe benefits resulting from the proposed increase for salaries and wages. In accordance with the adjustment to salaries and wages expense the Commission has reduced the proposed adjustment to payroll taxes and fringe benefits by \$922 to \$2,336.

Electrical Expense

Berea proposed an adjustment of \$8,896 to increase electrical expense to reflect the increased cost of electricity during the test year. The Commission has increased the adjustment to electrical expense by \$4,667, to \$13,563, to reflect an increase in electric rates of Berea College Electric Utility effective September 23, 1982. This increase was necessary to flow-through a wholesale

increase by Kentucky Utilities Company, Berea's wholesale power supplier.

Depreciation expense

Berea proposed to increase depreciation expense by \$7,655, to \$108,216, to reflect additions to plant in service subsequent to the test year and through the month of June 1982. The Commission will allow depreciation expense only on those additions to plant related to the reservoir improvement project. In addition, the Commission has reduced depreciation expense to reflect the \$105,000 adjustment to contributed property. Based on Berea's depreciation rate for the reservoir improvement project, the proposed adjustment has been reduced by \$1,592, to \$6,063.

Rate Case Expense

Berea proposed an adjustment of \$8,500 to amortize its projected rate case expense of \$25,500 over a period of 3 years. In response to an information request by the Commission, Berea updated its projection to reflect total rate case expense of \$32,175. The Commission has reviewed the application and the record established in this matter and is of the opinion that the proposed adjustment for rate case expense is excessive and should not be allowed. The Commission finds that the request for an interim rate increase, the loss of customer data during the change in computer equipment, and the timing of this rate application in relation to the completion of the reservoir improvement project are the direct result of decisions and actions of the management of Berea and the costs thereof should not be borne by the ratepayers. Also, as pointed out by Mr. Salzman, Berea's rate consultant, the preparation

of the bill frequency analysis for this case should result in an ongoing benefit for Berea in that less time and expense for an outside consultant will be required in future rate cases.

Acknowledging these factors and taking into consideration that 4 years have passed since Berea's most recent rate increase, the Commission is of the opinion that \$6,375, or one-fourth of the amount originally projected, should be allowed for rate-making purposes.

Interest Expense

Berea proposed an adjustment of \$70,167 to increase interest expense on short-term debt of \$700,379. Berea later increased this adjustment by \$1,480 to reflect additional borrowings subsequent to the test year of \$10,621. The Commission will allow additional interest expense only on those borrowings related to the reservoir improvement project, the \$700,379 included in the calculation of the original adjustment. Berea's proposed adjustment was based on the rate of interest in effect at June 7, 1982, which was 13.93 percent. Since early June the interest rate charged on these borrowings has decreased to a low of 12.03 percent for the month of September 1982. Having considered the evidence of record and current costs and trends, the Commission is of the opinion that an interest rate of 13 percent should be utilized to determine the appropriate adjustment for interest expense on short-term debt. This results in an adjustment of \$63,653 or \$6,514 less than the original adjustment proposed by Berea.

The effect of the revised pro forma adjustments on net income is as follows:

	<u>Actual Test Period</u>	<u>Pro Forma Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$738,539	\$ -0-	\$738,539
Operating Expenses	441,582	40,328	481,910
Operating Income	<u>\$296,957</u>	<u>\$<40,328></u>	<u>\$256,629</u>
Interest on Long-Term Debt	293,125	-0-	293,125
Other Deductions	<u>29,246</u>	<u>63,653</u>	<u>92,899</u>
Net Income	<u>\$<25,414></u>	<u>\$<103,981></u>	<u>\$<129,395></u>

REVENUE REQUIREMENTS

The actual rate of return on Berea's net investment rate base established herein for rate-making purposes was 6.32 percent. After taking into consideration the accepted pro forma adjustments, Berea would realize a rate of return of 5.46 percent. The Commission is of the opinion that the adjusted rate of return is inadequate and a more reasonable rate of return would be 9.62 percent. In order to achieve this rate of return, Berea should be allowed to increase its annual revenue by approximately \$195,110 which will provide net income of \$65,715. This additional revenue should allow Berea to pay its operating expenses, service its debt, and provide an adequate surplus for equity growth.

OTHER ISSUES

Transactions with Berea College

The City took issue with the transactions between Berea and the College, claiming the expenses for those transactions should not be allowed for rate-making purposes due to the nature of the relationship between the two entities. The Commission is of the opinion that such expenses are reasonable and necessary for the operation of the utility and that the City has submitted no evidence to support its contention that these transactions inflate

Berea's operating expenses in such a way that allows it greater earnings than it appears to have. Likewise, the Commission is of the opinion that the City has offered no proof that the magnitude of these expenses is unreasonable or that the College is earning a profit on these transactions. Therefore, the Commission concludes that the adjusted operating expenses set out herein are just and reasonable and should be allowed for rate-making purposes.

Rate Design

Berea proposed to adjust its revenue by increasing its present rates by various percentages while maintaining its current rate structure. The proposed increases were 32.9 percent for metered water sales, 37.9 percent for sales for resale and 29 percent for fire protection. Having reviewed the proposed rates and the current rate structure, the Commission is of the opinion that, in the absence of a cost of service study, the current rate structure should be maintained and each rate should be increased proportionately based on the increase granted herein.

The City maintained that the proposed public fire hydrant rental is arbitrary and unreasonable and should not be approved. The City proposed, in its filed brief, that the fire hydrant rental should be maintained at its current level. The Commission is of the opinion that the increased costs Berea is incurring are the result of providing service to all classes of customers and these costs should be borne by all customers. Accordingly, all rates have been adjusted upward in order to generate the additional revenue granted herein.

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 the fair, just and reasonable rates for Berea and will produce gross annual operating revenue of approximately \$933,649.

2. The rates proposed by Berea would produce revenue in excess of that found reasonable herein and should be denied upon application of KRS 278.030.

IT IS THEREFORE ORDERED that the rates in Appendix A be and they hereby are approved for service rendered by Berea on and after November 25, 1982.

IT IS FURTHER ORDERED that the rates proposed by Berea be and they hereby are denied.

IT IS FURTHER ORDERED that within 30 days from the date of this Order Berea shall file with the Commission its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 24th day of November, 1982.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE COMMISSION IN CASE NO. 8531 DATED NOVEMBER 24, 1982

The following rates and charges are prescribed for the customers in the area served by Berea College Water Utility. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the date of this Order.

Residential, Commercial and Industrial

	Rate per Month
First 200 cu. ft.	\$4.90 Minimum Bill
Next 1,800 cu. ft.	2.35 per 100 cu. ft.
Next 3,000 cu. ft.	2.10 per 100 cu. ft.
Next 5,000 cu. ft.	1.85 per 100 cu. ft.
Next 5,000 cu. ft.	1.50 per 100 cu. ft.
All Over 15,000 cu. ft.	1.25 per 100 cu. ft.

Minimum Bill: \$4.90 per month for which 200 cu. ft. or less of water shall be delivered.

Wholesale Water Rates

	Rate per Month
All wholesale water sales	\$1.15 per 1,000 gallons

Fire Protection Service

	Rate per Month
Lines 6" in diameter or under	\$33.00
Lines 8" in diameter	46.50
Lines 10" in diameter	60.00
Lines 12" in diameter	73.00

Public and Private Fire Hydrant Rentals

	Rate per Year
Fire Hydrants	\$116.00