

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF SALT RIVER)
WATER DISTRICT FOR AN) CASE NO. 8782
ADJUSTMENT OF RATES)

O R D E R

On June 2, 1983, Salt River Water District ("Salt River") filed its application with this Commission to increase its rates pursuant to 807 KAR 5:076, Alternative Rate Adjustment Procedure for Small Utilities ("ARF"). The proposed rates would produce additional revenue of \$90,504 annually, an increase of 72 percent. On July 20, 1983, Salt River amended its application to reduce the request to \$65,837 annually or 53 percent. Based on the determination herein the revenues of Salt River will increase by \$25,090 annually, an increase of 21 percent. In addition, Salt River will be allowed to collect \$14,967 per year for 3 years through a surcharge in order to collect sufficient revenue to make past due bond payments.

No hearing was held in this matter, and accordingly, the decision of the Commission is based on information contained in the application, written submissions, annual reports and other documents on file in the Commission's offices.

COMMENTARY

Salt River is a nonprofit water distribution system organized and existing under the laws of the Commonwealth of Kentucky and presently serves approximately 732 customers in Bullitt County, Kentucky.

TEST PERIOD

The Commission has adopted the 12-month period ending December 31, 1982, as the test period for determining the reasonableness of the proposed rates. In utilizing the historical test period, the Commission has given full consideration to known and measurable changes found reasonable.

REVENUES AND EXPENSES

Salt River proposed several adjustments to revenues and expenses in its original application. The Commission is of the opinion that the proposed adjustments are generally proper and acceptable for rate-making purposes with the following modifications:

Revenue Normalization

The operating statement of Salt River for the test period reflected operating revenue of \$124,556. Salt River proposed an adjustment of \$2,968 to decrease its commercial revenues for the loss of three commercial customers whose operations have ceased and to reflect the cutback of operations of a fourth commercial customer. While the Commission acknowledges that Salt River will in fact suffer a loss in commercial revenues due to the loss of these customers it also acknowledges that there will be certain corresponding reductions in expenses related to the discontinuance

of service to these customers. Salt River did not propose any corresponding reductions to its expenses. Therefore, the Commission in accordance with established rate-making policy has disallowed Salt River's proposed adjustment.

In addition, in response to the Commission's second information request Salt River indicated that it had included tap-on fees totaling \$3,291 in the test year operating revenues. The Commission has, therefore, reduced Salt River's operating revenue by \$3,291 to reflect the removal of the tap-on fees in accordance with the Uniform System of Accounts and established rate-making policy.

Electric Expense

Salt River proposed an adjustment to increase its electric expense by \$1,278 above its reported test period expense of \$14,564. In order to assess the accuracy of the reported level of expense, as well as to determine the adjusted electric expense, the Commission requested and Salt River supplied copies of its test period electric bills from Salt River RECC. The Commission has determined that the test period expense included an expenditure of \$627 for the operation of a temporary gasoline driven pump which should be a nonrecurring expense. In addition, during several months of the test period Salt River included as electric expense amounts representing charges carried forward from previous periods. In calculating the adjusted electric expense the Commission has removed the charges that were carried forward and the cost of gasoline incurred to operate the temporary pump. The Commission has applied the current electric rates in effect to

the actual KWH used by Salt River during the test year. This results in adjusted electric expense of \$14,890 and an adjustment of \$326.

Filter Rehabilitation

During 1982 and 1983 Salt River completed a major rehabilitation of the filtration system in its treatment plant. The total cost of the rehabilitation was \$9,276, of which \$6,686 relates to materials and labor and \$2,590 represents engineering fees. Of the total materials and labor cost, \$3,340 was included in the test period level of expense and reported in Account 635 - Maintenance of Treatment Plant. Salt River has proposed an adjustment to include the full amount of the engineering fees as an expense in the determination of its rates.

Upon an analysis of the filter rehabilitation the Commission finds that the costs associated with this project should be capitalized in accordance with the Uniform System of Accounts. Accordingly, the Commission has reduced Salt River's test year expenses by \$3,340 and has rejected the adjustment to include the engineering fees of \$2,590 as an expense for rate-making purposes. Furthermore, the Commission finds that the cost of the filter rehabilitation should be depreciated over an 8-year period and has increased Salt River's depreciation expense by \$1,160 to reflect one-eighth of the project's total cost.

Depreciation Expense

The operating statement of Salt River for the test period reflected depreciation expense of \$12,801. It is the policy of the Commission to compute depreciation expense for rate-making

purposes on non-contributed property only (i.e., the net original cost of plant in service less contributions in aid of construction). Salt River's balance sheet reflected contributions in aid of construction at the end of the test year of \$80,652 which is approximately 18 percent of the total cost of utility plant in service. In determining the pro forma depreciation expense the Commission has utilized the level of non-contributed plant in service at the end of the test year and the composite depreciation rate used by Salt River. This results in an annual straight line depreciation expense of \$10,501. In addition, the Commission has included depreciation expense for the cost of the filter rehabilitation which was capitalized and explained in an earlier adjustment. Depreciating the \$9,276 installed cost of the rehabilitation over an 8-year estimated life results in additional annual depreciation expense of \$1,160. To reflect these adjustments, the Commission has reduced Salt River's annual depreciation expense by \$1,140 for rate-making purposes to \$11,661.

Rate Case Expense

Salt River proposed an adjustment to include in operating expenses its full rate case expense of \$2,650. The breakdown of this total included Accounting fees of \$100, Legal fees of \$50 and Engineering fees of \$2,500. The Commission is very concerned with the level of rate case expense reported by small utilities using the ARF filing procedure, as the ARF procedure was instituted in large part to reduce the cost of professional fees involved in a general rate case. The Commission required Salt River to file a

detailed breakdown of the rate case expense and an explanation of any unusual or unique situations which would justify the reported level of expense. Both Salt River and its engineering firm responded to the request with written explanations.

In 1982, the Judge Executive of Bullitt County replaced two of the three commissioners of the water district. The water district was at the time, and currently is, in very poor financial condition. Inadequate records had been maintained and system maintenance had been neglected. The commissioners of the water district felt it imperative to pursue a rate increase but felt that due to their lack of experience and the urgency of the situation that outside professional assistance would be necessary to a large degree. Salt River feels that the level of rate case expense is justifiable for those reasons.

The Commission is of the opinion that given these rather unique circumstances, the level of rate case expense incurred in this case is not unreasonable. However, the Commission wishes to advise Salt River that it expects that as the new commissioners gain experience and the financial condition of the district improves that expenditures of this level for the preparation of any future ARF cases may not be allowed.

The Commission has noted that the test period expenses included \$254 related to a prior rate case. The Commission therefore has made an adjustment of \$630 for rate case expense which represents \$2,650 amortized over 3 years or \$884, less the \$254 already included in the test period.

Maintenance of Mains

Salt River proposed an adjustment to increase the level of expense in Account 651, Maintenance of Mains, by \$1,875, from \$1,125 to \$3,000. In support of its proposed adjustment Salt River provided a list of water mains which need maintenance and provided copies of invoices showing a level of expense of \$2,900 for maintenance of mains during the first 7 months after the test period.

The Commission shares Salt River's concern for the proper maintenance of its water mains and commends Salt River's present maintenance effort. However, Salt River has not provided sufficient evidence for the Commission to determine a known and measurable level of expense which can reasonably be expected to occur on an ongoing basis. While the \$2,900 of expense incurred during the first 7 months of 1983 is very close to the projected expense, Salt River's previous annual reports indicate that the recurring level of annual expense is much closer to the annual expense of the test period. Therefore, the Commission has disallowed Salt River's proposed increase to the test period expense for Account 651.

Maintenance of Pumping Plant

During the test period Salt River completed major repairs of its pumping plant. These repairs, totaling \$8,083, were determined to be nonrecurring expenses and Salt River proposed an adjustment to eliminate them from the test period. The Commission has reviewed the invoices supplied in support of the repairs and concurs with Salt River's determination that these expenses will

not be expected to recur on an annual basis. However, the Commission has determined that the expenses would ordinarily be considered extraordinary in nature and be amortized over the period for which they would not reasonably be expected to recur. The Commission has determined 10 years to be a reasonable time period over which to amortize repairs of this nature, and therefore, has increased Salt River's expenses by \$808 to reflect the amortization of these expenses.

Depreciation Fund and Debt Reserve Fund

Salt River proposed adjustments totaling \$3,200 to reflect the deposits to its depreciation reserve fund and debt service fund required by its bond ordinances. The depreciation reserve fund is intended to provide funds for major repairs and replacements of plant while the debt service reserve fund is intended to provide funds for the timely payment of Salt River's long-term debt. The Commission, in establishing a utility's revenue requirements, considers separately each expense which has a required reserve fund. In the depreciation adjustment and by granting a 1.2X debt service coverage, the Commission has provided Salt River sufficient revenues to make the necessary deposits to these funds. Therefore, in accordance with its established policy, the Commission had disallowed Salt River's proposed adjustments.

The Commission finds that Salt River's adjusted test period operations are as follows:

	<u>Actual Test Period</u>	<u>Pro forma Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$124,556	\$<3,291>	\$ 121,265
Operating Expenses	<u>125,594</u>	<u><5,672></u>	<u>119,922</u>
Operating Income	\$ <1,038>	\$ 2,381	\$ 1,343
Other Income	267	432	699
Other Deductions	<u>9,631</u>	<u>283</u>	<u>9,914</u>
Net Income	<u>\$<10,402></u>	<u>\$ 2,530</u>	<u>\$ <7,872></u>

REVENUE REQUIREMENTS

The Commission is of the opinion that the adjusted test period operating loss is clearly unjust and unreasonable and finds the debt service coverage method to be a fair, just and reasonable method of determining revenue requirements in this case. The debt service coverage method will allow Salt River to pay its operating expenses, meet its debt service requirements and maintain a reasonable surplus. The Commission is of the opinion that a debt service coverage of 1.2X is fair, just and reasonable and has determined Salt River's total revenue requirement to be \$147,054. In order to generate this level of revenue, Salt River will require additional revenues of \$25,090 annually.

Salt River proposed to collect \$14,967 annually over a 3-year period in order to make bond payments for the years 1981 and 1982 which are past due. When its new commissioners took office in 1982 Salt River was, and currently is, in arrears on bond payments totaling \$44,900 for 1981 and 1982. In an effort to provide for the payment of these obligations Salt River has established an account at Bullitt Federal Savings and Loan Association ("Bullitt Federal") for the purpose of depositing

funds over a 3-year period in order to make the past due bond payments. The contract with Bullitt Federal specifies that the deposited funds will be remitted by Bullitt Federal only to the bondholders of Salt River.

The Commission has reviewed the contract with Bullitt Federal and finds this method to be a reasonable way for Salt River to provide for the payment to its bondholders. However, due to the fact that this will not be considered a normal recurring expense and due to the difficulty of assuring that only the amount necessary to make the past due bond payments is collected, the Commission is of the opinion that the proper method of collecting the needed revenue is through a surcharge to be collected over a 3-year period. In this way the amount collected can be more easily monitored and the surcharge can be removed when the necessary funds have been collected. Therefore, Salt River has been granted a surcharge to collect \$44,900 over a 3-year period, for the purpose of generating sufficient funds to make the past due bond payments. The surcharge granted herein will cease immediately upon collection of the funds necessary to make the bond payments for the years 1981 and 1982, or 3 years from the date of this Order, whichever comes first.

SUMMARY

The Commission, after consideration of 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 Salt River in that they will produce gross annual revenue of \$147,054. These revenues will be sufficient to meet Salt River's operating expenses found reasonable for rate-making purposes, service its debt and provide a reasonable surplus.

2. The rates proposed by Salt River would produce revenue in excess of that found reasonable herein and should be denied.

3. Salt River's operations will be materially impaired unless funds are provided to make past due bond payments.

4. A surcharge is the most reasonable method of collecting the necessary funds to make the past due bond payments.

5. Salt River should file with the Commission copies of deposit slips showing the monthly payments to Bullitt Federal and, when final payment is made by Bullitt Federal to Salt River's bondholders, certification from the bondholder that the payments have been made in full.

IT IS THEREFORE ORDERED that the rates in Appendix A be and they hereby are approved as the fair, just and reasonable rates to be charged by Salt River for service rendered on and after the date of this Order.

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

IT IS FURTHER ORDERED that the surcharge in Appendix A be and it hereby is approved effective as of the date of this Order until such time as the bond payments in arrears have been paid in full, or 3 years from the date of this Order, whichever comes first.

IT IS FURTHER ORDERED that Salt River shall file with the Commission copies of deposit slips showing the monthly payments to Bullitt Federal and certification from the bondholders that the entire amount of the bond payments in arrears have been paid.


IT IS FURTHER ORDERED that within 30 days of the date of this Order Salt River shall file its revised tariff sheets setting forth the rates and temporary surcharge approved herein.

Done at Frankfort, Kentucky, this 13th day of October, 1983.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION IN CASE NO. 8782 DATED October 13, 1983.

The following rates are prescribed for the Salt River Water District. 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 effective date of this Order.

RESIDENTIAL

GALLONAGE BLOCK

RATE

First 3,000 gallons	\$ 9.20 (minimum)
Next 5,000 gallons	1.60 per 1,000 gallons
Next 7,000 gallons	1.40 per 1,000 gallons
Next 10,000 gallons	1.35 per 1,000 gallons
Over 25,000 gallons	1.25 per 1,000 gallons

COMMERCIAL

GALLONAGE BLOCK

RATE

First 3,000 gallons	\$10.20 (minimum)
Next 5,000 gallons	1.80 per 1,000 gallons
Over 8,000 gallons	1.55 per 1,000 gallons

SURCHARGE

A surcharge of \$1.70 will be added to the basic monthly bill of each customer for a period of 3 years.