

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

NOTICE BY BRONSTON WATER)
ASSOCIATION, INC., TO) CASE NO. 8800
INCREASE ITS WATER RATES)

O R D E R

On April 1, 1983, Bronston Water Association, Inc., ("Bronston") filed an application with this Commission giving notice of its intention to adjust water rates effective April 20, 1983. Bronston stated that the proposed rates would produce additional annual revenues of \$11,254, thus reflecting an increase of 11.3 percent on the level of test year revenues. Finding that an investigation to determine the reasonableness of these rates could not be completed before the proposed effective date, the Commission, in its Order dated April 4, 1983, suspended the tariffs, thereby deferring the application of the rates until September 20, 1983. In addition, in the Order of Case No. 5522-2, Purchase Water Adjustment of Bronston Water Association, dated June 13, 1983, the Commission granted Bronston a purchased water adjustment of \$.11 per 1,000 gallons of water sold, which necessitated the normalization of Bronston's test year revenue to reflect the effect of this adjustment. The rates requested by Bronston would result in an increase of \$8,678 based on normalized test year revenues. Based upon the determination herein, the

revenues of Bronston will be increased by an annual amount of \$1,014, which represents an increase of 1 percent.

A motion to intervene in this matter was filed by Woodson Bend Property Owners Association, Inc., ("Woodson Bend") on April 25, 1983, and was sustained by the Commission. On June 22, 1983, a hearing was held in the Commission's offices in Frankfort, Kentucky. Subsequently, on July 22, 1983, Woodson Bend requested that an additional hearing be scheduled, contending that it was not given notice of the Commission's Order of April 25, 1983, which sustained the motion to intervene. Therefore, Woodson Bend maintained that it was not adequately prepared for the hearing of June 22, 1983. The Commission determined that Woodson Bend had not been given notice of the April 25, 1983, Order, and thus held a further hearing on August 26, 1983.

Additionally, on September 1, 1983, Woodson Bend submitted a motion to file a brief in this matter, contending that the information would aid the Commission in identifying the relevant issues of this case. Bronston filed an opposition to this motion on September 8, 1983, maintaining that all of the case issues had been clearly addressed during the course of the filing of the application and the subsequent two hearings. However, the Commission, by its Order dated September 9, 1983, sustained the motion, and briefs were filed by both parties on September 15, 1983.

COMMENTARY

Bronston is a non-profit water association organized and existing under the laws of the Commonwealth of Kentucky, and serves approximately 565 customers in Pulaski County.

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 historic test period, the Commission has given full consideration to known and measurable changes found reasonable.

REVENUES AND EXPENSES

Bronston proposed several adjustments to its test period revenues and expenses. The Commission is of the opinion that the proposed adjustments are generally proper and acceptable for rate-making purposes, with certain modifications.

Revenue Normalization

Bronston adjusted its test year revenue by \$9,091 to reflect normalized revenue resulting from an increase granted pursuant to 807 KAR 5:067, Purchased Water Adjustment Clause, in Case No. 5522-1, Purchased Water Adjustment of Bronston Water Association, Inc., effective October 6, 1982. Subsequent to the filing of this case, Bronston filed another application (Case No. 5522-2) requesting permission to adjust its rates pursuant to 807 KAR 5:067 due to an additional increase in purchased water costs from its supplier, Monticello Utilities Commission. The increase was granted effective for services rendered on and after June 13, 1983. The Commission has made a further adjustment of \$4,087 to

Bronston's test year revenue resulting from the June 13, 1983, purchased water adjustment. With this adjustment, Bronston's normalized test year revenue from water sales is \$105,167.

Interest Income

Bronston proposed an adjustment to reduce test year interest income by \$2,623. In determining the adjustment, Bronston excluded from interest income the interest, principal and coverage requirements associated with unadvanced debt of \$36,671. However, the unadvanced funds are not on deposit with Bronston, but with its lender, The Farmers Home Administration ("FmHA"); thus, Bronston did not earn interest income during the test year on these funds. Mr. Dell Coleman, CPA, witness for Bronston, testified that its basis for the adjustment was to estimate the effect of the lower interest rates that would be earned on its certificates of deposit, and the effect of the additions that will be made to its existing system.^{1/} However, the Commission finds that Bronston's adjustment does not support its contention and is without merit. Therefore, the Commission has reduced interest income by \$2,025 to reflect the interest being earned at current rates on each investment held at the end of the test year. This reduction results in adjusted interest income of \$4,215.

Interest Expense

Bronston proposed an adjustment to reduce test year interest expense by \$4,263. In determining the adjustment, Bronston used the level of accrued interest as of July 1, 1983, and excluded from this amount the interest expense associated with unadvanced debt of \$36,671.^{2/} The Commission has reduced test

year interest expense by \$7,664 to reflect the level of interest expense on all debt outstanding as of December 31, 1982.^{3/}

After consideration of the aforementioned adjustments, the Commission finds that Bronston's test period operations are as follows:

	<u>Actual Test Period</u>	<u>Pro Forma Adjustments</u>	<u>Adjusted Test Year</u>
Operating Revenue	\$ 93,928	\$ 13,178	\$107,106
Operating Expenses	<u>96,375</u>	<u>(3,394)</u>	<u>92,981</u>
Operating Income	(2,447)	16,572	14,125
Interest on Long Term Debt	18,423	(7,664)	10,759
Interest Income	<u>6,240</u>	<u>(2,025)</u>	<u>4,215</u>
Net Income	<u><u>\$(14,630)</u></u>	<u><u>\$ 22,211</u></u>	<u><u>\$ 7,581</u></u>

REVENUE REQUIREMENTS

In determining its test period revenue requirements, Bronston used a 1.2X debt service coverage based on a 5-year average of principal payments, and the test year annualized interest expense plus operating expenses. In the calculation, Bronston excluded the principal, interest, and coverage requirements associated with unadvanced loan funds of \$36,671. In determining the unadvanced loan funds, Bronston subtracted the cost of the new tank in the amount of \$172,329 from the approved loan of \$209,000. However, the actual unadvanced loan funds for this project were \$101,200.^{4/} The \$209,000 of construction and financing was approved by the Commission's April 17, 1981, Order in Case No. 8159.^{5/} Upon completion of the project, Bronston had only utilized \$107,800 of the total approved loan funds. Bronston stated that it plans to use the remaining funds for extensions and

improvements which will add several new customers to the system.^{6/} Bronston has not sought approval for the proposed additional construction from the Commission, nor has it included any revenue and expense adjustments to reflect these additions. As a result, the Commission is of the opinion that only the principal and interest payments on the loan funds actually drawn down should be incorporated into the calculation of Bronston's revenue requirements. The principal and interest on a \$107,800 note based upon an interest rate of 5 percent for a period of 40 years results in annual payments in the amount of \$6,282.^{7/}

The Commission recognizes the fact that Bronston is actually making payments in accordance with the covenants of the previously approved loan of \$209,000, although only \$107,800 of these funds has been drawn down. In addition, Bronston has indicated that the utilization of the unadvanced loan funds will result in additional customers, which will provide added income to Bronston. However, until such time as the plans are finalized and Commission approval is sought and granted for the utilization of these funds, the Commission has determined that the terms of payment of the \$209,000 loan should be renegotiated with FmHA to reflect the annual payment requirements based upon the actual amount of funds drawn down.

In determining the revenue requirements in this case, the Commission has used a 1.2X debt service coverage based upon a 5-year average of principal and interest payments, plus the operating expenses allowed herein. This computation results in a total revenue requirement of \$112,335.

OTHER ISSUES

Accounting Records

During the hearing of June 22, 1983, the witness for Bronston, Mr. Coleman, testified that Bronston's accountant, in preparing the annual report of operations, closed construction funds of \$107,171 to the utility plant in service account. These funds represented the unadvanced portion of the \$209,000 FmHA loan. In addition, Mr. Coleman related that, in his preparation of Bronston's application, he reduced depreciation expense by the proper amount associated with these construction funds; he further indicated that he could not ascertain the reason that Bronston's accountant had reported these funds in this manner.^{8/}

Citing these funds as not representative of the value of the components of utility plant currently in service, and having found no substantiation in the uniform system of accounts for this method of recording such funds, the Commission is of the opinion that this accounting practice is not justified. Therefore, Bronston should make the appropriate adjusting journal entry that will remove these funds from its utility plant accounts, and should subsequently record the funds in the proper non-plant asset account.

During the hearing of August 26, 1983, it was revealed that Woodson Bend paid construction costs of approximately \$27,000 to install a 2-inch meter and a connecting line into the resort property.^{9/} In consideration of the fact that Woodson Bend incurred the cost of the installation of these components of utility plant, the Commission has determined that the associated

construction costs of approximately \$27,000 constitute contributed property. Therefore, Bronston should make the appropriate journal entry that will record on its books of account the utility plant in service and contributions in aid of construction associated with these facilities.

Rate Design

Bronston's present rate structure consists of separate rate schedules for services provided through meters 3/4-inch x 5/8-inch, 1-inch, 1 1/2-inches and 2-inches in size and for one special contract customer, Woodson Bend. The rates charged under each schedule are identical except that the minimum usages for which a customer must pay a minimum bill are 1,500, 5,000, 10,000, 20,000 and 600,000 gallons, respectively.

Bronston proposed to change its rate design by deleting the minimum usage levels for larger meters, establishing a rate schedule for commercial customers at the rates and usage levels presently applicable to service provided through 3/4-inch x 5/8-inch meters and establishing a rate schedule for residential customers retaining the same usage levels, but with a reduction from the present rates of approximately 10.37 percent. No change was requested in the rate structure for Woodson Bend; however, Bronston proposed to increase rates to this customer by approximately 86.09 percent.

Mr. Coleman testified that all customers are served through 3/4-inch x 5/8-inch meters except Woodson Bend which is served through a 2-inch meter. Average residential usage is approximately 3,325 gallons per month; average commercial usage is

approximately 4,315 gallons per month; and the commercial customers consist of small businesses such as grocery stores.^{10/} The Commission agrees that Bronston should be allowed to delete the minimum usages and bills for larger meters since none of these meters are in use; however, the Commission sees no substantial difference in the service provided to residential and small business customers in this instance which would justify higher rates for the commercial customers.

Cost of Service Study

In further support of its proposed change in rate design, Bronston filed a cost of service study^{11/} prepared by Mr. Coleman^{12/} which concluded that the special contract customer, Woodson Bend, was not paying its fair share of Bronston's cost of service.^{13/}

The cost study used four allocation factors as a basis of assigning costs to the different customer classes - ratios to the total system of usage by customer class, number of customers in each class, revenue generated by customer class, and cost of plant in service. While the Commission agrees that these are reasonable factors upon which to assign costs, the application of these factors by Bronston to the various cost elements raises serious questions as to the validity of the cost study.

Bronston filed a partial payment estimate from FMHA and a bid schedule in support of its categorization of transmission and distribution plant.^{14/} No system map or other evidence was presented to show in any detail where the various plant items are located or how they are used. This exhibit shows the cost of the

distribution line to serve Woodson Bend to be \$14,120 with remaining distribution plant of \$92,959 allocated to residential customers. The Commission sees no reason why some portion of the remaining distribution plant should not be allocated to commercial customers.

Bronston has two distribution reservoirs consisting of a 100,000-gallon tank located in the northwestern portion of the service area and a 200,000-gallon tank located in the eastern portion of the service area. Bronston assigned the cost of the smaller tank (\$24,108) to residential and commercial customers based on usage and the entire cost of the 200,000-gallon tank (\$172,329) to Woodson Bend.^{15/} Bronston contended that the 200,000-gallon tank was built for the purpose of serving Woodson Bend and, in support of that contention, filed a memorandum dated March 23, 1981, from Mr. Byrnes Fairchild to Mr. Richard Heman,^{16/} both members of the Commission's staff, which states that additional storage capacity ordered by the Commission in Case No. 6209 in April of 1975 includes: "a 200,000-gallon storage tank situated as feasibly as possible to the area of highest usage--the Woodson Bend Resort." However, Bronston's witness, Mr. Coleman, testified that this tank can be and has been used to provide service to other customers.^{17/} Further, a map filed by Woodson Bend^{18/} shows that water must be fed back toward the main portion of the system in order to serve Woodson Bend from this tank and that both existing and proposed lines extend beyond the tank south of Woodson Bend and away from the main portion of the system. Bronston did not question the accuracy of this map. Both of these

tanks are available and beneficial to the entire system; thus, allocation of the cost of these tanks in this manner does not provide an equitable distribution of costs.

The Commission is of the opinion that these items noted herein are sufficient to render the cost of service study invalid as a basis for determining the rates and that further details of its analysis are unnecessary for the purposes of this Order.

The Commission agrees with Bronston that cost causative factors must bear heavily in rate determination and urges Bronston to file a revised cost study with any future application for rate adjustment. However, the Commission is also committed to the principles of gradualism in rate adjustment which would not justify the reduction of rates to some customers while increasing the rates to others by more than 86 percent.

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 Bronston, as they will produce annual revenue of \$108,120. This revenue, along with interest income of \$4,215, will be sufficient to meet Bronston's operating expenses found reasonable for rate-making purposes, service its debt, and provide a reasonable surplus.

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

3. Bronston should be required to report to the Commission within 60 days of the date of this Order regarding efforts to

renegotiate the \$209,000 FmHA loan to reflect annual payment requirements based upon the amount of funds drawn down.

4. Bronston has failed to provide sufficient justification for the proposed change in rate design; the change should, therefore, be denied with the exception that minimum usage levels and bills for meters larger than 3/4-inch x 5/8-inch should be deleted.

IT IS THEREFORE ORDERED that the rates proposed by Bronston be and they hereby are denied.

IT IS FURTHER ORDERED that the proposed change in rate design be and it hereby is denied except that minimum usage levels and bills for service provided through meters larger than 3/4-inch x 5/8-inch shall be deleted.

IT IS FURTHER ORDERED that the rates in Appendix A be and they hereby are approved for service rendered by Bronston on and after the date of this Order.

IT IS FURTHER ORDERED that, within 30 days of the date of this Order, Bronston shall file its revised tariff sheets setting forth the rates approved herein.

IT IS FURTHER ORDERED that, within 60 days of the date of this Order, Bronston shall report the results of its efforts to renegotiate the terms of payment of the \$209,000 loan with FmHA.

Done at Frankfort, Kentucky, this 23rd day of September,
1983.

PUBLIC SERVICE COMMISSION


Chairman

Did Not Participate
Vice Chairman


Commissioner

ATTEST:

Secretary

FOOTNOTES

1. Transcript of Evidence ("T.E."), June 22, 1983, pp. 76-77.

2. Application Exhibit 2, Schedule 4.

3.	<u>Principal Balance</u>	<u>Interest Rate</u>	<u>Interest Expense</u>	<u>Applicable to Test Yr.</u>	<u>Annualized Expense</u>
\$107,800 Loan:					
07-01-81	\$107,800*	5%	\$ 5,390	50%	\$ 2,695
07-01-82	106,908*	5%	5,345	50%	2,673
\$166,100 Loan:					
12-31-82	107,816	5%	5,391	100%	<u>5,391</u>
Total Allowable Interest Expense					\$ 10,759
Test Year Actual Interest Expense					<u>18,423</u>
Reduction to Actual					<u><u>(\$7,664)</u></u>

*Based upon amortization schedule per response to Item No. 2 of Commission's Order dated September 9, 1983.

4. Exhibit 3 of June 22, 1983, hearing.

5. The Application of the Bronston Water Association, Inc., a Non-profit Corporation Incorporated Pursuant to Chapter 273 of the Kentucky Revised Statutes, Which Has Its Principal Place of Business in Pulaski County, Kentucky, for (1) a Certificate of Public Convenience and Necessity, Authorizing and Permitting Said Association to Construct a Waterworks Construction Project Consisting of Improvements to the Existing Waterworks System of the Association, and (2) Approval of the Proposed Plan of Financing Said Project.

6. T.E., June 22, 1983, pp. 78-80.

7. Schedule of amortization of principal and interest payments, response to Item No. 2 of the Commission's Order dated September 9, 1983.

8. T.E., June 22, 1983, p. 48.

9. T.E., August 26, 1983, p. 28.

10. T.E., June 22, 1983, pp. 88, 90.

11. Application, Exhibit 2.

12. Prefiled Testimony of Dell Coleman, pp. 3-18.

13. Ibid., p. 3.

14. Exhibit 2, Schedule 7.
15. Exhibit 2, Schedule 7a.
16. Exhibit 2, Schedule 7b, Appendix B.
17. T.E., June 22, 1983, pp. 34, 35, 109; T.E., August 26, 1983, p. 72.
18. Intervenor's Exhibit 1, August 26, 1983.

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 8800 DATED SEPTEMBER 23, 1983

The following rates and charges are prescribed for the customers receiving water service from Bronston Water Association. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

Residential and Commercial

5/8-Inch X 3/4-Inch Meters

<u>Gallage Block</u>	<u>Rate</u>
First 1,500 gallons	\$6.80 (Minimum)
Next 3,500 gallons	2.75 per 1,000 gallons
Next 5,000 gallons	2.00 per 1,000 gallons
Next 5,000 gallons	1.50 per 1,000 gallons
Over 15,000 gallons	1.20 per 1,000 gallons

Special Contract: Woodson Bend, Inc.

<u>Gallage Block</u>	<u>Rate</u>
First 600,000 gallons	\$1,496.00 (Minimum)
Over 600,000 gallons	1.20 per 1,000 gallons