

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

APPLICATION OF FANCY FARM WATER)
DISTRICT FOR AUTHORITY TO ADJUST)
RATES FOR WATER SERVICE AND FOR) CASE NO. 8849
A CERTIFICATE OF CONVENIENCE AND)
NECESSITY TO CONSTRUCT FACILITIES)

O R D E R

On May 26, 1983, the Fancy Farm Water District ("Fancy Farm") filed its application with the Commission requesting an increase in water rates pursuant to 807 KAR 5:076. On July 8, 1983, in response to a Commission request, Fancy Farm filed an amended application requesting approval of financing and certification of a \$70,000 waterworks improvement project. Fancy Farm proposed to finance the project from cash reserves. The proposed improvements provide an additional waterwell which should bring Fancy Farm's system into compliance with the standards of the Division of Water of the Natural Resources and Environmental Protection Cabinet ("Natural Resources").

Plans and specifications for the proposed improvements as prepared by Florence and Hutcheson, Inc., of Paducah, Kentucky, ("Engineer") have been approved by Natural Resources.

A hearing was held in the offices of the Public Service Commission, Frankfort, Kentucky, on August 25, 1983. Fancy Farm

Concerned Citizens and the Attorney General's Division of Consumer Protection intervened.

Fancy Farm requested approval of increased rates to provide additional revenues of \$25,000. In this Order the Commission has approved the proposed construction and approved rates to provide additional revenues of \$5,938.

TEST PERIOD

Fancy Farm proposed and the Commission has accepted the 12-month period ending December 31, 1982, as the test period in this case.

REVENUES AND EXPENSES

Fancy Farm had net operating income of \$1,555 for the test period. Fancy Farm proposed numerous adjustments to revenues and expenses based on assumed inflation increases with no documentation, unsubstantiated estimates, and averages of various expense accounts for 1981 and 1982. The Commission has rejected all adjustments proposed by Fancy Farm, except for its proposed increase to administrative and general salaries of \$1,100 and its adjustment to remove school tax receipts collected and remitted in the amount of \$1,216, as the Commission's policy is to accept only known and measurable increases in test period expenses. The Commission has made the following additional adjustments to Fancy Farm's test period operations:

Depreciation Expense

Fancy Farm did not propose to increase its depreciation expense to allow for depreciation on the proposed construction. The Commission is of the opinion that such an adjustment is

necessary to reflect normal operations after completion of the project. Accordingly, the Commission has increased the test-period depreciation expense of \$11,430 by \$1,497 to reflect additional depreciation on plant additions at the 3 percent composite rate used for total plant in 1982.¹

Furthermore, it is the Commission's policy that depreciation expense be computed on the basis of original cost of the plant in service less contributions in aid of construction, as a utility should not be allowed recovery on that portion of the plant which has been provided at zero cost. Thus, the Commission has reduced depreciation expense by \$5,437 to exclude depreciation on contributed property, which results in adjusted net depreciation expense of \$7,490.²

Therefore, Fancy Farm's test period operations have been adjusted as follows:

| | <u>Per Books</u> | <u>Adjustments</u> | <u>Adjusted</u> |
|----------------------|------------------|--------------------|-----------------|
| Operating Revenue | \$ 38,737 | \$ 0 | \$ 38,737 |
| Operating Expenses | <u>37,182</u> | <u>(4,057)</u> | <u>33,125</u> |
| Net Operating Income | <u>\$ 1,555</u> | <u>\$ 4,057</u> | <u>\$ 5,612</u> |

¹ $\$11,430 \div \$378,939 = 3\% \times \$49,875 = \$1,497.$

² $\$378,939$ (Plant in Service) - $\$179,169$ (Contributions in Aid of Construction) = $\$199,770 \times 3\% = \$5,993 + \$1,497 = \$7,490.$

REVENUE REQUIREMENTS

Fancy Farm's annual debt service based on outstanding debt at the end of 1982 is \$13,792.³ Fancy Farm's adjusted net operating income of \$5,612 plus pro forma interest income from water operations of \$5,000 provides a debt service coverage ("DSC") of .77X.⁴ The Commission is of the opinion that this coverage is unfair, unjust and unreasonable. Fancy Farm proposed a DSC of 1.5X in accordance with its bond ordinance and the Commission's Order in Case No. 8685 (An Adjustment of Rates of Fancy Farm Water District), which determined that an increase in revenue was not warranted to Fancy Farm because its adjusted operations produced a 1.48X DSC. The Commission's normal policy, however, is to allow revenues to provide a 1.2X DSC. The Commission in Case No. 8685 allowed Fancy Farm to maintain its 1.48X DSC because adherence to its normal policy of a 1.2X DSC would have resulted in a reduction in Fancy Farm's rates which appeared unwarranted at the time as Fancy Farm's financial position and earnings appeared to be eroding. The Commission is of the opinion that a DSC of 1.2X is the fair, just and reasonable coverage necessary for Fancy Farm to pay its operating

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|---------------------------------------|-----------------|
| ³ Bonds (Water Operations) | |
| Principal (5-year average 1983-1987) | \$ 8,000 |
| Interest | <u>5,792</u> |
| | <u>\$13,792</u> |

⁴ $\$5,612 + \$5,000 = \$10,612 \div \$13,792 = .77$

expenses and to meet the requirements of its bondholders.⁵ Accordingly the Commission has determined that additional revenue of \$5,938⁶ is necessary to provide the 1.2X DSC which will ensure the future financial stability of Fancy Farm.

RATE DESIGN

Fancy Farm presently bills its residential and commercial customers on a declining block rate schedule that contains eight steps. Fancy Farm has proposed to reduce the number of steps in its rate schedule to seven by combining two steps. The Commission is of the opinion that this change in rate design is in the best interest of Fancy Farm and its customers and should be approved.

Fancy Farm serves Milburn Water District ("Milburn") under a wholesale rate schedule. There is presently a minimum charge for the first 100,000 gallons and a flat rate per 1,000 gallons for all water used in excess of 100,000 gallons. Fancy Farm has proposed to increase the amount of water allowed in the minimum charge to 400,000 gallons and maintain a flat rate per 1,000 gallons for all water used over 400,000 gallons. The Commission

⁵ The 1.5X coverage required by Fancy Farm's bond ordinance is calculated exclusive of depreciation (p. 26 of Exhibit 3 submitted at the August 25, 1983, hearing.) The Commission calculation of a 1.2X DSC including depreciation results in a greater revenue requirement than that of the bond ordinance; hence, the 1.2X DSC used by the Commission meets the terms of the bond ordinance.

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|--------------|----------------------------------|---------------|
| ⁶ | Adjusted Operating Expenses | \$33,125 |
| | 1.2X Debt Service (\$13,792) | <u>16,550</u> |
| | Revenue Requirement | \$49,675 |
| | Less: Adjusted Operating Revenue | |
| | + Interest Income | <u>43,737</u> |
| | Increase Allowed | \$ 5,938 |

is of the opinion that the proposed change in Fancy Farm's wholesale rate structure is fair, just, and reasonable and should be approved.

Fancy Farm provided the Commission with a calculation of the cost of providing water service to Milburn shown on Schedule five of its application. Schedule five shows that it costs Fancy Farm approximately 80 cents per 1,000 gallons to serve Milburn. The wholesale rates proposed by Fancy Farm for service to Milburn result in an average rate of 64 cents per 1,000 gallons based on annual usage by Milburn. The Commission is of the opinion that Fancy Farm's residential and commercial customers should not subsidize its wholesale customer. Therefore, Fancy Farm's wholesale rate has been increased in order to cover the cost of supplying service to Milburn.

SUMMARY

The Public Service Commission, after consideration of the application and evidence of record and being advised, is of the opinion and finds that:

1. Public convenience and necessity require that the construction proposed in the application and record be performed and that a certificate of public convenience and necessity be granted.

2. The proposed construction includes drilling a water well on Fancy Farm's property capable of providing 150 gallons per minute of water and miscellaneous appurtenances thereto. This construction will bring Fancy Farm's source of supply facilities into compliance with Natural Resources' standards. The low bids

received for the proposed work totaled \$43,875 which will require about \$49,875 after allowances are made for fees, contingencies and other indirect costs.

3. Any deviations from the construction herein approved which could adversely affect service to any customer should be subject to the prior approval of this Commission.

4. Fancy Farm proposes to finance this project by utilizing cash reserves. Fancy Farm's financing plan is reasonable and should, therefore, be approved.

5. Fancy Farm should file with the Commission duly verified documentation which shows the total costs of construction and all other capitalized costs (engineering, legal, administrative, etc.) within 60 days of the date that construction is substantially completed.

6. Fancy Farm's contract with its Engineer should require the provision of construction inspection under the general supervision of a professional engineer with a Kentucky registration in civil or mechanical engineering. This supervision and inspection should insure that the construction work is done in accordance with the contract plans and specifications and in conformance with the best practices of the construction trades involved in the project.

7. Fancy Farm should require the Engineer to furnish a copy of the record plans and a signed statement that the construction has been satisfactorily completed in accordance with the contract plans and specifications within 60 days of the date of substantial completion of this construction.

8. Fancy Farm should file with the Commission a copy of all contractual agreements for the provision of services or the purchase of services which are subject to the approval of this Commission.

9. The rates proposed by Fancy Farm will produce revenues in excess of the revenues found reasonable herein and should be denied upon application of KRS 278.030.

10. The rates and charges in Appendix A are the fair, just, and reasonable rates to be charged by Fancy Farm in that they should produce the revenue required by Fancy Farm.

IT IS THEREFORE ORDERED that Fancy Farm be and it hereby is granted a certificate of public convenience and necessity to proceed with the waterworks improvements project set forth in the plans and specifications of record herein.

IT IS FURTHER ORDERED that any deviations from the approved construction which could adversely affect service to any customer shall be subject to the prior approval of this Commission.

IT IS FURTHER ORDERED that Fancy Farm shall file with the Commission duly verified documentation which shows the total costs of construction herein certificated including all capitalized costs (engineering, legal, administrative, etc.) within 60 days of the date that construction is substantially completed.

IT IS FURTHER ORDERED that the contract between Fancy Farm and its Engineer shall require the provision of construction inspection under the general supervision of a professional engineer with a Kentucky registration in civil or mechanical engineering. This supervision and inspection shall insure that

the construction work is done in accordance with the contract plans and specifications and in conformance with the best practices of the construction trades involved in the project.

IT IS FURTHER ORDERED that Fancy Farm shall require the Engineer to furnish to the Commission a copy of the record plans and a signed statement that the construction has been satisfactorily completed and done in accordance with the contract plans and specifications within 60 days of the date of substantial completion of the proposed construction.

IT IS FURTHER ORDERED that Fancy Farm shall file with the Commission a copy of all contractual agreements for the provision of services or for the purchase of services which are subject to the approval of this Commission.

IT IS FURTHER ORDERED that the rates proposed by Fancy Farm be and they hereby are denied upon application of KRS 278.030.

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

IT IS FURTHER ORDERED that within 30 days of the date of this Order, Fancy Farm shall file its tariffs setting out the rates approved in Appendix A.

Nothing contained herein shall be deemed a warranty of the Commonwealth of Kentucky, or any agency thereof, of the financing herein authorized.

Done at Frankfort, Kentucky, this 15th day of December, 1983.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION IN CASE NO. 8849 DATED December 15, 1983.

The following rates are prescribed for the customers in the area served by Fancy Farm 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 date of this Order.

Rates: Monthly

| | | |
|-------|-----------------|------------------------|
| First | 2,000 gallons | \$ 4.25 Minimum Bill |
| Next | 3,000 gallons | 1.05 per 1,000 gallons |
| Next | 5,000 gallons | 1.00 per 1,000 gallons |
| Next | 10,000 gallons | .95 per 1,000 gallons |
| Next | 30,000 gallons | .90 per 1,000 gallons |
| Next | 50,000 gallons | .85 per 1,000 gallons |
| Over | 100,000 gallons | .80 per 1,000 gallons |

Milburn Water District

| | | |
|-------|-----------------|-----------------------|
| First | 400,000 gallons | \$320.00 Minimum Bill |
| Over | 400,000 gallons | .80 per 1,000 gallons |