

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

* • * * *

In the Matter of:

PURCHASED WATER ADJUSTMENT OF)
MARTIN COUNTY WATER DISTRICT NO. 2) CASE NO. 7505-1

O R D E R

On May 3, 1984, the Martin County Water District No. 2 ("Martin No. 2") filed an application with the Commission for permission to increase the rates charged to its customers in accordance with the provisions of its purchased water adjustment clause on file with the Commission. In this proceeding the Commission has found that Martin No. 2 can partially absorb the increased cost of water and has, therefore, allowed an increase of \$5,892.

BACKGROUND

Until October, 1983, Martin No. 2 purchased its water from Martin County Water District No. 1 ("Martin No. 1") for \$.60 per 1,000 gallons. In the latter part of 1983, Martin No. 1, because of internal problems in its system, became unable to supply 100 percent of Martin No. 2's required water. Consequently, Martin No. 2 found it necessary to purchase some of its water from the City of Kermit, West Virginia, ("Kermit") at \$1.20 per 1,000 gallons. In its application, Martin No. 2 estimated that approximately 50 percent of its water would have to be purchased from Kermit at the higher rate.

COMMENTARY

The Commission is of the opinion that the events in this case do not specifically constitute a purchased water adjustment under 807 KAR 5:067 in that no change in the base rate has occurred. Martin No. 2 recognizes this fact by stating in its application that "this request is not a normal or usual PWA." However, after due investigation, the Commission is also of the opinion that Martin No. 2 will continue to find it necessary to purchase a portion of its water from Kermit in that Martin No. 1 is not expected to be able to serve 100 percent of Martin No. 2's demand for water in the foreseeable future. Therefore, the Commission is further of the opinion that since Martin No. 2 has experienced an increase in its purchased water cost that will continue into the foreseeable future, Martin No. 2's filing should appropriately be treated as a purchased water adjustment.

Prior to approving increased rates resulting from purchased water cost increases pursuant to 807 KAR 5:067, the Commission must examine an applicant's financial condition to determine whether it can absorb any of the increased cost. If there is potential for absorption, the Commission may adjust rates to offset only that portion of the increased water cost which cannot be absorbed.

TEST PERIOD

In order to determine the reasonableness of the proposed purchased water adjustment and the increase in rates, the Commission has adopted the 12-month period ended December 31, 1983, as the test period in this matter. Adjustments deemed

proper and reasonable have been included to more accurately reflect current operating conditions.

REVENUES AND EXPENSES

The rates proposed by Martin No. 2 would increase revenues by \$23,220 to offset the increased cost of purchased water. No other adjustments were proposed. The Commission has made the following adjustments to expenses, in conformance with its rate-making policy, to more fairly represent the actual operating expenses of Martin No. 2:

Depreciation Expense

Martin No. 2's test period depreciation expense was \$34,713. This reflects depreciation on total plant using a composite rate of approximately 2.29 percent.¹ It is the Commission's policy to compute depreciation expense for rate-making purposes on the basis of original cost of plant in service less contributions in aid of construction. The balance sheet of Martin No. 2 shows contributions in aid of construction at the end of the test period to be \$969,215. This amount is approximately 64 percent of the total cost of the utility plant in service. In determining the pro forma depreciation expense, the Commission has utilized the depreciation rate applied by Martin No. 2 and has excluded depreciation associated with contributed property. The adjusted depreciation expense for rate-making

¹ $\$34,713 \div \$1,517,026 = 2.29\%$.

purposes is \$12,594.² Therefore, the Commission has reduced test period depreciation expense by \$22,119.

Purchased Water

During the test period, Martin No. 2 had purchased water cost of \$56,619. Martin No. 2's 1983 Annual Report reflected water loss for the test period to be approximately 30.18 percent, which is in excess of the maximum of 15 percent allowed by the Commission for rate-making purposes. Thus, the Commission has determined the allowable gallons of purchased water for rate-making purposes to be 78,049,217 gallons.³ Using the average cost of water during the test period of 59.6 cents per 1000 gallons, allowable water cost is \$46,517.

In order to adjust purchased water cost to reflect purchases from Kermit, the Commission found it necessary to analyze actual purchases from its two suppliers for the months of October, 1983, through August, 1984, the most recent data available. During these months, it was found that Martin No. 2 purchased approximately 30 percent of its water from Kermit. It is the Commission's opinion that this ratio more accurately reflects future water purchases than the estimate of 50 percent

2	Total Plant	\$1,519,178
	Less: Contributions in Aid of Construction	969,215
	Non-Contributed Plant	<u>\$ 549,963</u>
	Composite Rate	<u>X 2.298</u>
	Depreciation Allowed for Rate-Making	<u>\$ 12,594</u>

3	66,341,834 gallons (Water Sold + Company Usage) + 0.85 =
	78,049,217 gallons

made by Martin No. 2. Therefore, the Commission has determined Martin No. 2's adjusted test period purchased water cost to be \$60,879⁴ based on allowable water purchases of 78,049,217 allowable gallons, an increase in water cost of \$14,362.

Therefore, the Commission finds that Martin No. 2's adjusted test period operations are as follows:

	<u>Actual</u>	<u>Adjustments</u>	<u>Adjusted</u>
Operating Revenues	\$217,216	\$ -0-	\$217,216
Operating Expenses	<u>203,766</u>	<u><17,859></u>	<u>185,907</u>
Operating Income	<u>\$ 13,450</u>	<u>\$ 17,859</u>	<u>\$ 31,309</u>

REVENUE REQUIREMENTS

Martin No. 2's annual debt service based on outstanding debt at the end of the test period is \$33,570.⁵ Martin No. 2's adjusted net operating income of \$31,309 plus interest income from water operations of \$3,083 provides a debt service coverage ("DSC") of approximately 1.02X. The Commission is of the opinion that this coverage is unfair, unjust and unreasonable.

4

Adjusted Purchased Water Cost

<u>Supplier</u>	<u>Average Purchases</u>	<u>Average Gallons</u>	<u>Price/000 Gallons</u>	<u>Cost</u>
Martin County	70.0%	54,634,452	\$.60	\$32,781
Kermit	30.0%	23,414,765	\$ 1.20	28,098
Totals	<u>100.0%</u>	<u>78,049,217</u>		<u>\$60,879</u>

5

Bonds (5-year average principal 1984-88)	\$ 7,600
Interest (5-year average 1984-88)	<u>25,970</u>
Debt Service	<u>\$33,570</u>

Therefore, the Commission is of the opinion that a net operating income of \$40,284 will provide a DSC of 1.2X, which is the fair, just and reasonable coverage necessary for Martin No. 2 to pay its operating expenses and to meet the requirements of its lenders. Accordingly, the Commission has determined that additional revenue of \$5,892 is necessary to provide the 1.2X DSC which will ensure the financial stability of Martin No. 2.

SUMMARY

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

1. Martin No. 2's need to purchase a portion of its water at a higher price constitutes a change in the base rate.

2. Martin No. 2 possesses the potential to absorb a portion of the increase in purchased water cost.

3. The rates proposed by Martin No. 2 will produce revenues in excess of those found reasonable herein and should be denied upon application of KRS 278.030.

4. The rates and charges in Appendix A are the fair, just and reasonable rates to be charged by Martin No. 2 in that they should produce total revenues of \$226,196 and will provide funds to pay operating expenses and provide a DSC of 1.2X.

IT IS THEREFORE ORDERED that the rates requested by Martin No. 2 be and they hereby are denied.


IT IS FURTHER ORDERED that the rates and charges in Appendix A are the fair, just and reasonable rates and charges to

be charged by Martin No. 2 for water service rendered on and after the date of this Order.

IT IS FURTHER ORDERED that Martin No. 2 shall file with the Commission within 30 days of the date of this Order its revised tariff sheets setting forth the rates and charges approved herein.

Done at Frankfort, Kentucky, this 12th day of December, 1984.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION IN CASE NO. 7505-1 DATED 12/12/84

The following rates are prescribed for customers of Martin County Water District No. 2. 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.

<u>Usage Block</u>	<u>Rate</u>
First 2,000 gallons	\$ 9.33 Minimum
Next 4,000 gallons	3.29 per 1,000 gallons
Next 4,000 gallons	3.19 per 1,000 gallons
Next 10,000 gallons	3.09 per 1,000 gallons
Next 20,000 gallons	2.64 per 1,000 gallons
Next 60,000 gallons	2.04 per 1,000 gallons
Over 100,000 gallons	1.24 per 1,000 gallons

Special Contract Customers

Warfield Elementary

First 75,000 gallons	\$190.35 Minimum
Next 25,000 gallons	2.04 per 1,000 gallons
Over 100,000 gallons	1.24 per 1,000 gallons

Pigeon Roost School

First 60,000 gallons	\$159.75 Minimum
Next 40,000 gallons	2.04 per 1,000 gallons
Over 100,000 gallons	1.24 per 1,000 gallons

Peter Cave Coal/Wolf Creek Collierie

First 100,000 gallons	\$241.35 Minimum
Over 100,000 gallons	1.24 per 1,000 gallons

Dempsey Housing

First 80,000 gallons	\$207.20 Minimum
Over 80,000 gallons	2.09 per 1,000 gallons