

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF BIG SANDY)
WATERWORKS, INC., FOR AN)
ADJUSTMENT OF RATES PURSUANT) CASE NO. 8951
TO THE ALTERNATIVE PROCEDURE)
FOR SMALL UTILITIES)

O R D E R

On December 15, 1983, Big Sandy Waterworks, Inc., ("Big Sandy") filed an application with the Commission to increase its water rates pursuant to 807 KAR 5:076. This regulation allows utilities with 400 or fewer customers or \$200,000 or less gross annual revenues to use the alternative rate filing method in order to minimize the necessity for formal hearings, to reduce filing requirements and to shorten the time between the application and the Commission's final Order. This procedure should minimize rate case expenses to the utility and, therefore, should result in lower rates to the ratepayers.

There were no intervenors in this matter, and all information requested by the Commission has been submitted.

Big Sandy requested rates which would produce an annual increase of \$46,270 from its 428 customers. In this Order, the Commission has allowed rates to produce an increase of \$20,782.

TEST PERIOD

For the purpose of determining the reasonableness of the proposed rates, the 12-month period ending December 31, 1982, has been accepted as the test period.

REVENUES AND EXPENSES

Big Sandy incurred a net profit for the test period of \$1,051. Big Sandy proposed several pro forma adjustments to its test period operating revenues and expenses to more accurately reflect current operating conditions. The Commission finds these adjustments reasonable and has accepted them for rate-making purposes with the following exceptions:

Operating Revenues

The 1982 annual report of Big Sandy showed test period operating revenues of \$72,531. The billing analysis, as provided by Big Sandy, indicated 1982 revenues of \$72,561, which included temporary service revenues of \$2,142 to the Richmond Hills Estates Subdivision (John's Creek Area) during the test period. Subsequent to the test period, the Auxier Water Company constructed a water line to the subdivision and is presently providing water service to Richmond Hills. Based on the billing analysis information submitted by Big Sandy, the Commission finds that a net adjustment of \$2,112 is required to eliminate these non-recurring sales, resulting in normalized test year revenues of \$70,419.

Operating Salaries

During the test period, Michael Wiley, President and General Manager, and Dallas Salyer, General Maintenance Employee,

received \$15,300 and \$6,000, respectively, for services rendered. These salaries were in addition to disbursements for miscellaneous contract labor. Big Sandy proposed the following pro forma adjustments to the annual salaries of its present employees and proposed a position of office manager whose duties will consist of preparing the monthly water bills and collection of same and other general office functions:

<u>Employee</u>	<u>Present Salary</u>	<u>Proposed Salary</u>	<u>Increase</u>
Michael J. Wiley	\$15,300	\$20,000	\$ 4,700
Dallas Salyer	6,000	12,500	6,500
Lynda Wiley	-0-	10,700	

In its last rate case, Case No. 8631, Application of Big Sandy Water Works, Inc., for an Adjustment of Rates Pursuant to the Alternative Procedure for Small Utilities, Big Sandy proposed and the Commission accepted the calendar year 1981 as the test period in that case. The salaries accepted for rate-making purposes in that case for Mike Wiley and Dallas Salyer were \$15,300 and \$6,000, respectively. Big Sandy presented no proof to justify that the duties of these employees varied significantly from those performed during the test period in the last rate case.

The Commission finds it unreasonable for Big Sandy to expect its customers to bear such large salary increases. The Consumer Price Index ("CPI") is a primary measure of inflation and since the test period in the last case, the calendar year ending

December 1981, the change in the CPI through December 1983 was 10.7.¹ The CPI is frequently used by industry in setting wage increases and the Commission finds it to be useful in analyzing the salary adjustments shown above. After giving due consideration to all factors involved in arriving at an equitable salary for the present employees, the Commission is of the opinion that the maximum increase, for rate-making purposes, that should be passed on to Big Sandy's customers is an increase equal to the change in the CPI since Big Sandy's last rate case. Moreover, the Commission has compared the proposed salary of the office manager of \$10,700 to those of other utilities of similar size and operating characteristics under the jurisdiction of the Commission and finds that \$6,500 per year is a reasonable salary for the utility to pay for this service and, thus, should be the amount allowable for inclusion in the adjusted operating expenses of Big Sandy. Therefore, the Commission will allow for operating salaries a total of \$30,079² rather than the \$43,200 as proposed.

¹ CPI-W Index:

$$\frac{\text{Average for Calendar Year 1981}}{\text{December 1983}} = \frac{272.3}{301.5} = 10.7\%.$$

² \$21,300 X 10.7% = \$2,279 + \$21,300 + \$6,500 = \$30,079.

Payroll Taxes

Big Sandy's recorded payroll tax expense for the test period was \$2,177. The Commission has allowed an additional \$792³ which has been computed on the basis of the allowable pro forma salary increases to the employees of \$8,779.

Depreciation Expense

Big Sandy recorded depreciation expense for the test period of \$4,098. The depreciation schedule for the year ended December 31, 1982, filed with the application of Big Sandy listed capital additions of \$8,528 made during the period February 19, 1981, through August 26, 1982, on which depreciation expense was computed using an accelerated method of depreciation. The Commission advised Big Sandy through its information Order dated January 27, 1984, that it recognizes only depreciation expense computed on the straight-line method for rate-making purposes. Big Sandy filed its response to the information Order on February 8, 1984, which included a revised depreciation schedule setting out adjusted depreciation expense of \$3,708. Therefore, the Commission has reduced depreciation expense for the test period by \$390.

3 Additional payroll tax expense:

Social Security Taxes (\$8,779 X 6.7 percent)	=	\$ 588
Unemployment Taxes (\$6,000 X 3.4 percent)	=	<u>204</u>
Total		<u>\$ 792</u>

Proposed Capital Additions and Equipment Purchases

Big Sandy proposed several pro forma adjustments to include the amortization of proposed capital additions and equipment purchases as follows:

Building Improvements	\$4,219
System Improvements	5,205
Truck Purchase	5,311
Purchase of Office Equipment	3,635

In its response to the Commission's information Order received February 8, 1984, Big Sandy stated that it was unable to negotiate a loan at the present time due to insufficient revenues to pay the debt cost. The Commission recognizes that Big Sandy will be required to borrow the funds for plant additions and equipment purchases through a bank or other lending institution. However, it is the Commission's policy not to grant pro forma adjustments which are neither known nor measurable. Therefore, the Commission will deny these proposed adjustments at this time.

In the event that Big Sandy is able to obtain a commitment for a loan from a bank or other lending institution with stipulated lending terms and can further submit adequate proof of such commitment of the allocation of the borrowed funds to specific construction and other capital items along with all construction specifications and a description of the necessity for these additions and purchases within 20 days of the date of this Order, the Commission will be receptive to a reconsideration on this matter.

Charitable Contributions

Big Sandy included \$330 in test period expenses representing donations to charitable organizations. It is the Commission's policy to disallow charitable contributions for rate-making purposes. Therefore, the Commission has reduced Big Sandy's operating expenses by \$330.

Thus, Big Sandy's adjusted operations at the end of the test period are as follows:

	<u>Big Sandy Adjusted</u>	<u>Commission Adjustments</u>	<u>Commission Adjusted</u>
Operating Revenues	\$ 72,531	\$ (2,112)	\$ 70,419
Operating Expenses	<u>101,039</u>	<u>(31,419)</u>	<u>69,620</u>
Operating Income (Loss)	\$ (28,508)	29,307	799
Interest Expense	<u>10,711</u>		<u>10,711</u>
Net Income (Loss)	<u>\$ (39,219)</u>	<u>\$ 29,307</u>	<u>\$ (9,912)</u>

REVENUE REQUIREMENTS

Big Sandy's annual debt service requirement is \$16,395.⁴ Big Sandy's adjusted operating income of \$799 provides a debt service coverage ("DSC") of .05X, and is clearly unfair, unjust and unreasonable. The Commission is of the opinion that a DSC of 1.2X is fair, just and reasonable in that it will meet the

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Calculation

Note dated Apr. 15, 1982:	\$841.13 (Prin. & Int.) X 12 =	\$10,094
Note dated Nov. 29, 1980:	\$250.00 (Prin. & Int.) X 12 =	3,000
Note dated Aug. 15, 1982:	\$275.13 (Prin. & Int.) X 12 =	<u>3,301</u>
Total - Annual Debt Service Requirement		<u>\$16,395</u>

requirements of Big Sandy's lenders and provide a fair, just and reasonable profit to Big Sandy's owners. Therefore, additional revenue of \$20,782 is required to achieve this DSC.⁵ The adjusted gross revenue of \$91,201, including federal and state income taxes of \$1,907,⁶ will allow Big Sandy to pay its operating expenses and meet the requirements of its creditors.

SUMMARY

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

1. The rates proposed by Big Sandy would produce revenues in excess of the revenues found reasonable herein and should be denied upon application of KRS 278.030.

5 Calculation:

Operating Expenses	\$69,620
Federal and State Income Taxes	1,907
1.2X DSC	<u>19,674</u>
Total Revenue Required	<u>\$91,201</u>

Less:

Test Period Operating Revenue	<u>70,419</u>
Increase Required	<u><u>\$20,782</u></u>

6 Calculation:

1.2X DSC	\$19,674
Less: Interest Expense	<u>10,711</u>
Net Income	<u>\$ 8,963</u>
+ 82.45%	
Taxable Income	\$10,871
X 17.55%	
Composite State and Federal Income Taxes	<u><u>\$ 1,907</u></u>

2. The rates in Appendix A are the fair, just and reasonable rates to charge for water service rendered to Big Sandy's customers and should produce annual revenues of approximately \$91,201.

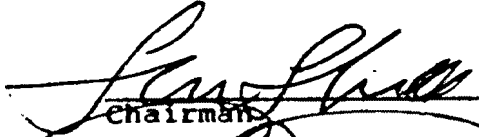
3. Big Sandy should adhere to the Uniform System of Accounts for Water Utilities as prescribed by this Commission especially in the area of proper classification of operating expenses. Moreover, the practice of making cash payouts from office receipts should be discontinued and the revenues deposited in the proper manner.

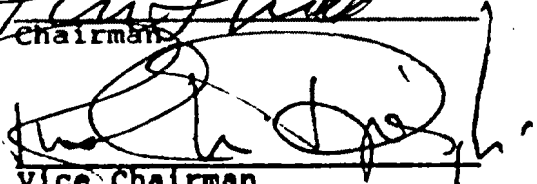
IT IS THEREFORE ORDERED that the rates in Appendix A be and they hereby are approved as the fair, just and reasonable rates to be charged by Big Sandy for water service rendered on and after the date of this Order.

IT IS FURTHER ORDERED that, within 30 days of the date of this Order, Big Sandy shall file with this Commission its tariff sheets setting forth the rates approved herein and a copy of its rules and regulations for providing water service.

Done at Frankfort, Kentucky, this 27th day of March, 1984.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman

ATTEST:

Secretary


Commissioner

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION IN CASE NO. 8951 DATED MARCH 27,
1984

The following rates are prescribed for customers in the area served by Big Sandy Waterworks, Inc. 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.

RATES: Monthly

First	1,000 gallons	\$10.00 Minimum Bill
Next	1,000 gallons	3.45 per 1,000 gallons
Next	3,000 gallons	3.00 per 1,000 gallons
Over	5,000 gallons	2.30 per 1,000 gallons