

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

SOUTH HOPKINS WATER DISTRICT'S)
NOTICE OF ADJUSTMENT OF RATES)
AND APPLICATION PURSUANT TO 807) CASE NO. 9016
KAR 5:001, SECTION 9, FOR)
AUTHORITY TO ADJUST RATES)

O R D E R

On March 22, 1984, the South Hopkins Water District ("South Hopkins") filed with the Commission an application requesting authority to increase its water rates. South Hopkins stated that the requested increase was necessary because revenue increases through expansion of services were insufficient to offset the increasing costs of operation.

After a review of South Hopkins' application, it was determined that the test-year income statement filed therein did not reflect actual test year operations as required by 807 KAR 5:001, Section 9(2). Therefore, the Commission, in its Order of April 17, 1984, requested that South Hopkins file an income statement based on actual test year operations.

South Hopkins responded to this request with revised exhibits indicating that it was requesting authority to increase its operating revenue by \$36,090 or 9.9 percent annually over its reported test-year operating revenues of \$365,252. The proposed

rates would result in a 13.2 percent increase in the average residential monthly bill based on usage of 4,372 gallons of water per month.

Based on the determination herein, South Hopkins' operating revenue will increase by \$36,090 over reported test-year operating revenue of \$365,252, an increase of 9.9 percent.

A public hearing was conducted August 29, 1984, at the Commission's offices in Frankfort, Kentucky. There were no intervenors in this proceeding.

COMMENTARY

South Hopkins is a non-profit water utility engaged in the treatment, distribution, and sale of water to approximately 1,759 customers in Hopkins and Caldwell counties, Kentucky.

TEST PERIOD

South Hopkins proposed and the Commission has accepted the 12-month period ending December 31, 1983, 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 appropriate known and measurable changes.

REVENUES AND EXPENSES

For the test period South Hopkins reported a net operating loss of \$56,535. South Hopkins proposed several pro forma adjustments to revenues and expenses to reflect more current and anticipated operating conditions. 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

South Hopkins reported total test year revenues of \$365,252. The Commission examined South Hopkins' breakdown of other operating revenue¹ and concluded that this account includes funds received for supplies ordered, and subsequently sold at cost, as a service to its customers.² Inasmuch as the Uniform System of Accounts for Class A and B Water Utilities makes no provision for such transactions to be recognized as operating revenues, it is the Commission's opinion that these revenues should not be recognized for rate-making purposes and it has, therefore, reduced reported test-year total revenues by \$1,118.³

Purchased Water

South Hopkins proposed an adjustment to purchased water expense of \$1,329 based on its "December, 1983, projection of water purchases;"⁴ however, no basis was provided in support of the amount of this adjustment. Upon further questioning by the Commission as to the basis for the level of this adjustment, South Hopkins filed a revised purchased water adjustment based on the annualization of water purchases for the first 8 months of 1984.⁵

¹ Response to Commission's Order dated April 17, 1984, Item No. 10.

² Transcript of Evidence, p. 14.

³ See section titled "Supplies Ordered for Customers", p. 10.

⁴ "Revised Comparative Income Statement", line no. 8.

⁵ Response to additional information requested at August 29, 1984, hearing, Item No. 1.

This method resulted in an adjustment of \$7,541 to the test-year purchased water expense.

South Hopkins presented no evidence that there has been an increase in its wholesale cost of purchased water; therefore, it is apparent that the revised increase is due solely to an increased volume of water sales for the first 8 months of 1984. In that the increased purchased water expense is offset by increased water sales revenue, it is inappropriate to recognize the expense resulting from the greater volume of purchases without recognizing the corresponding sales. As South Hopkins has not proposed a corresponding adjustment to sales, the Commission finds the proposed adjustment to purchased water expense unacceptable for rate-making purposes. Therefore, the Commission finds that the test year level is reasonable and representative of normal annual operations for South Hopkins and has used this amount for rate-making purposes herein.

Purchased Power

South Hopkins originally proposed an adjustment of \$2,288 to test-year purchased power expense.⁶ Subsequently, in response to the Commission's request to provide a basis for this amount, South Hopkins stated that, "the District can't substantiate an increase for the year 1984."⁷ To determine whether an adjustment was necessary, the Commission requested test-year electric bills

⁶ Response to Commission's Order dated July 9, 1984, Item No. 2.

⁷ Response to additional information requested at August 29, 1984, hearing, Item No. 2.

and current electric utility rate schedules applicable to South Hopkins.⁸ After applying test-year KWH usage to current rates, the Commission finds that test-year purchased power expense should be increased by \$532 to reflect an adjusted purchased power expense of \$13,807.

Maintenance Expense

South Hopkins reported maintenance expense of \$9,977 on its test-year income statement. At the Commission's request, South Hopkins provided an analysis of the reported test-year maintenance expense.⁹ An examination of this analysis indicated that some items that were expensed by South Hopkins during the test year should have been capitalized to utility plant in service. In order to make a determination on this matter, the Commission requested copies of the invoices associated with these expense items.¹⁰ A review of these invoices indicated that \$3,134¹¹ of capital items were improperly charged to maintenance expense during the test year; therefore, an adjustment has been made to reduce maintenance expense by \$3,134 to reflect a more normal, accurate and reasonable level of maintenance expense. The Commission requested South Hopkins to provide any evidence it

⁸ Response to Commission's Order dated April 17, 1984, Item No. 10.

⁹ Response to Commission's Order dated April 17, 1984, Item No. 4a.

¹⁰ Response to Commission's Order dated July 9, 1984, Item No. 1.

¹¹ Ibid.

deemed appropriate as to why the aforementioned expenditures should not be capitalized; however, no such evidence was submitted.¹²

In applying appropriate depreciation rates, it was determined that a \$128 adjustment to test-year depreciation expense was necessary to reflect the capitalization of these expenditures. Following is a schedule reflecting the accounts, the amounts of the capitalization entries, and the determination of the adjustment to depreciation expenses:

<u>Account No.</u>	<u>Account Title</u>	<u>Amount</u>	<u>Depreciation Rate</u>	<u>Annual Depreciation</u>
343	Trans. & Dist. Mains	\$1,150	40 years	\$ 29
346	Meters	169	20 years	8
347	Meter Installations	<u>1,815</u>	20 years	<u>91</u>
		\$3,134		\$128

Supplies and Postage

South Hopkins reported test-year supplies and postage expense of \$11,618 and proposed an adjustment to reduce this amount by \$1,130 to reflect a reclassification of expenditures to miscellaneous expense.¹³ The Commission finds this adjustment acceptable but also finds that several other adjustments to this account are necessary to reflect the cost savings associated with the purchase of a computer to perform the billing functions formerly fulfilled by a computerized billing service. According

¹² Transcript of August 28, 1984, Hearing, p. 27.

¹³ Response to Commission's Order dated July 9, 1984, Item No. 2.

to the analysis of supplies and postage expense,¹⁴ payments for billing services during the test year amounted to \$5,497. Since these payments which covered the calculation and preparation of bills will no longer be necessary, the Commission has reduced supplies and postage expense by this amount. Furthermore, in future years maintenance charges of \$1,548 will be incurred¹⁵ and \$980 of computer supplies will be purchased.¹⁶ Therefore, the Commission has increased supplies and postage expense by these amounts resulting in a net decrease of \$4,099 to this account. This results in \$7,519 for supplies and postage expense allowable for rate-making purposes.

Miscellaneous

South Hopkins proposed an adjustment to increase test-year miscellaneous expense by \$2,242, \$1,130 of which represented a reclassification of test year charges to supplies and postage, with the balance of \$1,112 approximating the annualization of charges to this account during the first 8 months of 1984.¹⁷ It is the Commission's opinion that the reclassification component of this proposed adjustment is appropriate; however, the \$1,112 balance is not a known and measurable adjustment to the test-year level of miscellaneous expense and should therefore be denied for

¹⁴ Response to Commission's Order dated April 17, 1984, Item No. 4.

¹⁵ Response to Commission's Order dated July 9, 1984, Item No. 5.

¹⁶ Response to additional information requested at August 28, 1984, hearing, Item No. 5.

¹⁷ Ibid., Item No. 8.

rate-making purposes. The result of this finding is to increase test-year miscellaneous expense by \$1,130.

Vehicle Expense

South Hopkins proposed an adjustment to increase vehicle expense to \$974 based on an "approximately 10 percent increase due to increased travel for additional 15 miles of line."¹⁸ Upon further questioning by the Commission as to the components of the calculation of this adjustment, South Hopkins responded that "the District can't substantiate an increase for the year 1984." Therefore, the Commission finds that there are no known and measurable changes applicable to this expense and has used the actual test-year level of vehicle expense for rate-making purposes herein.

Depreciation Expense

South Hopkins reported depreciation expense of \$79,706 for 1983 and proposed no adjustment to this amount within the "Revised Comparative Income Statement". However, it is the policy of the Commission to compute depreciation expense for rate-making purposes on non-contributed plant only. Such a policy insures that ratepayers pay only for the plant in which the utility has made an investment and not the plant which the utility has acquired through contributions.

In determining the appropriate depreciation adjustment, the Commission first recognized a \$128 adjustment to test-year

¹⁸ Response to Commission's Order dated July 9, 1984, Item No. 2.

depreciation expense and a \$3,134 adjustment to test-year-end plant-in-service.¹⁹ The ratio of year-end contributions in aid of construction to adjusted year-end plant-in-service was then determined to be 50.2 percent. This percentage of adjusted test-year depreciation expense was excluded for rate-making purposes and an adjustment of \$1,942 was made to reflect full depreciation of the \$9,706 cost of the new computer over 5 years. The net result is to reduce depreciation expense by \$38,006, to \$41,700.

Interest on Long-Term Debt

South Hopkins proposed an adjustment of \$930 to reduce test year interest on long-term debt to \$58,620. However, the Commission, after reviewing the October 17, 1967, and June 30, 1981, bond resolutions,²⁰ has determined that actual interest on these two loans due and payable in 1984 is \$59,500 and, therefore, has used this amount for rate-making purposes.

Other Interest

South Hopkins proposed no adjustment to other interest expense; however, it is the Commission's opinion that interest on the note for \$11,181 to acquire a computer to perform monthly billing is properly chargeable to this account and, therefore, an adjustment should be made to reflect the additional expense. The

¹⁹ See section titled "Maintenance Expense", p.p. 5-6.

²⁰ Response to Commission's Order dated April 17, 1984, Item No. 1.

note reflects total interest charges of \$1,475 payable over 3 years.²¹ It is the Commission's opinion that for rate-making purposes this amount should be amortized equally over 3 years, resulting in an adjustment to other interest expense of \$492.

Amortization of Rate Case

South Hopkins reports total legal and accounting expenses of \$7,567 associated with this rate proceeding.²² To allow recovery of this cost, it is the Commission's finding that this amount should be amortized over a 3-year period resulting in an adjustment of \$2,522 to test-year operating expense.

Supplies Ordered for Customers

South Hopkins included within its test-year operating expenses charges for supplies ordered and paid for by its customers. The receipt of payment by the customers for the supplies was accounted for in other operating revenues. An examination of South Hopkins' other operating revenue reflects \$1,118 of such supplies were ordered for its customers during the test year. In that the Uniform System of Accounts for Class A and B Water Utilities makes no provision for the recording of such transactions as operating expenses, it is the Commission's opinion that these charges to operating expense are not appropriate for rate-making purposes and it has, therefore, made an adjustment to reduce operating expense by this amount herein.

21 Ibid., Item No. 14a.

22 Response to additional information requested at August 28, 1984, hearing, Item No. 9.

After consideration of the aforementioned adjustments, the Commission finds South Hopkins's adjusted test-period operations to be as follows:

	<u>Actual Test Period</u>	<u>Pro Forma Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$ 356,664	\$ <1,118>	\$ 355,546
Operating Expenses	362,237	<38,026>	324,211
Net Operating Income	<5,573>	36,908	31,335
Interest Income	8,588	-0-	8,588
Interest Expense	59,550	<50>	59,500
Net Income	<u>\$ <56,535></u>	<u>\$ 36,958</u>	<u>\$ <19,577></u>

REVENUE REQUIREMENTS

Historically, the Commission has used the debt-service coverage ratio as the criterion for determining revenues for non-profit water utilities, and it finds no reason to deviate from this established policy in this proceeding. Using a debt-service coverage of 1.2 plus operating expenses, the Commission finds South Hopkins' total revenue requirement to be \$422,030. The revenue increase requested by South Hopkins will generate \$20,688 less than the amount found reasonable by the Commission. However, the Commission is of the opinion and finds that the revenue increase requested by South Hopkins will produce gross annual revenue sufficient to pay South Hopkins' operating expenses, service its debt, and provide a reasonable surplus for equity growth, and should therefore be approved.

RATE DESIGN

In addition to increased water usage rates, South Hopkins proposed to increase the minimum bill for 5/8-inch metered service. However, it did not propose to increase minimum bills for

other categories of metered service, thus giving a relative price advantage to some customers. This is inconsistent with standard Commission rate design practice. Therefore, the Commission will increase minimum bills for other metered service categories corresponding to the minimum bill increase for 5/8-inch metered service and water usage rates.

The rates ordered in Appendix A will yield the additional revenue from sales of water found reasonable in this Order.

SUMMARY

The Commission, having considered the evidence of record and being advised, is of the opinion and finds that:

1. South Hopkins' proposed rates are not fair, just and reasonable and should be denied.

2. The rates in Appendix A are fair, just and reasonable rates for South Hopkins and will produce gross annual revenue sufficient to pay its operating expenses, service its debt, and provide a reasonable surplus for equity growth.

IT IS THEREFORE ORDERED that South Hopkins' proposed rates be and they hereby are denied.

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

IT IS FURTHER ORDERED that within 30 days from the date of this Order South Hopkins shall file with this Commission its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 3rd day of October, 1984.

PUBLIC SERVICE COMMISSION

Richard D. Demant
Chairman

Ruth L. Joseph
Vice Chairman

Joe Shuck
Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION IN CASE NO. 9016 DATED 10/3/84

The following rates are prescribed for customers in the area served by South Hopkins 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.

<u>Gallonge Blocks for Each Meter Size</u>	<u>Rate for Each Gallonge Block</u>
<u>5/8-Inch x 3/4-Inch Meter:</u>	
First 1,000 gallons per month	\$ 6.25 (Minimum Bill)
Next 9,000 gallons per month	2.75 per 1,000 gallons
Next 10,000 gallons per month	2.35 per 1,000 gallons
Next 30,000 gallons per month	2.00 per 1,000 gallons
Over 50,000 gallons per month	1.50 per 1,000 gallons
<u>3/4-Inch Meter:</u>	
First 5,000 gallons per month	\$ 17.25 (Minimum Bill)
Next 5,000 gallons per month	2.75 per 1,000 gallons
Next 10,000 gallons per month	2.35 per 1,000 gallons
Next 30,000 gallons per month	2.00 per 1,000 gallons
Over 50,000 gallons per month	1.50 per 1,000 gallons
<u>1-Inch Meter:</u>	
First 10,000 gallons per month	\$ 31.00 (Minimum Bill)
Next 10,000 gallons per month	2.35 per 1,000 gallons
Next 30,000 gallons per month	2.00 per 1,000 gallons
Over 50,000 gallons per month	1.50 per 1,000 gallons
<u>2-Inch Meter:</u>	
First 20,000 gallons per month	\$ 54.50 (Minimum Bill)
Next 30,000 gallons per month	2.00 per 1,000 gallons
Over 50,000 gallons per month	1.50 per 1,000 gallons
<u>3-Inch Meter:</u>	
First 50,000 gallons per month	\$114.50 (Minimum Bill)
Over 50,000 gallons per month	1.50 per 1,000 gallons