

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF ROY POTTER)
WATER SERVICE FOR AN ADJUSTMENT)
OF RATES PURSUANT TO THE) CASE NO. 9062
ALTERNATIVE PROCEDURE FOR)
SMALL UTILITIES)

O R D E R

The Roy Potter Water Service ("Potter") filed on May 3, 1984, its application for rate adjustment for small utilities pursuant to 807 KAR 5:076. This regulation provides a simplified and less expensive procedure for certain utilities in applying to the Commission for rate increases. To qualify for alternative rate filing a utility must have 400 or fewer customer billings or \$200,000 or less gross annual revenues.

BACKGROUND

Potter serves approximately 46 customers in Ashcamp, Kentucky. Customers are currently charged a \$15 flat monthly fee for water, which Potter proposes to increase to \$25 in this proceeding. Potter has recently found it necessary to make significant capital improvements to its system in complying with various state regulations. The funding of these capital improvements has seriously impaired Potter's cash flow and such capital expenditures are the basis for the filing of this case. In its attempt to properly evaluate this case, the Commission has

discovered that Potter's accounting records have not been maintained in accordance with the Uniform System of Accounts for Class D Water Utilities. The Commission thus advises Potter to adhere to the prescribed Uniform System of Accounts in maintaining all future records.

During its review of this case the Commission received letters from two customers opposed to the proposed rate increase; however, no motion was made for intervention. Although one letter suggested that Potter's assets might be used in a course of business other than the water system, the Commission, after investigation of the matter, finds no merit in the contention.

TEST PERIOD

Potter has proposed and the Commission has accepted the fiscal year ended December 31, 1983, as the appropriate test period in this case.

REVENUES AND EXPENSES

According to the annual report on file with the Commission, Potter had a net operating income of \$78 for the test period. In this proceeding Potter has proposed rates that would generate revenue of \$13,800 or an increase of \$5,520.

Potter has also proposed several adjustments to test period expenses in order to more accurately reflect operating conditions. It is the Commission's policy to accept only known and measurable adjustments to test period expenses. Accordingly, after proper review, the Commission has accepted Potter's adjustments with the following exceptions:

Maintenance and Repair

Potter's test period expense for maintenance and repair was \$1,235. According to Potter's filing of July 6, 1984, approximately \$974 of that amount was associated with pipe replacement. The Commission is of the opinion that pipe replacement constitutes a significant enhancement to the existing system and further that the cost should be capitalized and subsequently recovered through depreciation over the asset's estimated useful life. Potter proposed to increase test period expense by \$565 to allow for additional pipe replacement. The Commission is of the opinion that the cost of pipe to be replaced in the future should also be capitalized and, therefore, should not be included as a projected operating expense. Potter indicated that \$261 was spent during the test period for ordinary maintenance.¹ Therefore, the Commission has determined that \$261 is the appropriate expense level and has thus made the necessary adjustments.²

Owner's Salary

The owner's salary during the test period was \$2,400. Although no adjustment to this expense was proposed by Potter, the Commission is of the opinion that this level of compensation is quite low. However, in keeping with its policy to accept only

¹ Response filed July 6, 1984, Item 6, page 5.

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| | |
|------------------------|---------------|
| Test Period Expense | \$1,235 |
| Less: Pipe Replacement | 974 |
| Allowable Expense | <u>\$ 261</u> |

known and measurable adjustments to test period expenses, the Commission has made no adjustment to test period owner's salary expense.

Total Salaries (except owner)

Potter's test period salary expense was \$2,067 and \$4,867 was the proposed level for this expense. Following is a breakdown of the proposed salaries:

| | |
|-------------|--------------|
| Bookkeeper | \$2,400 |
| Water Man | 1,200 |
| Other Labor | <u>1,267</u> |
| Total | \$4,867 |

The Commission has determined that the salaries proposed for the bookkeeper and certified water man are reasonable and therefore has accepted them as proper.

Although Potter proposed no adjustment to other labor expense of \$1,267, it was discovered that approximately 66 percent of this expense was incurred in pipe replacement.³ The Commission is of the opinion that this cost constitutes a capital expenditure, and appropriately should be capitalized. Thus, the Commission accepts Potter's estimate of \$422 as the appropriate level of expense for the repair of normal system wear and tear or usual preventative maintenance. The Commission has adjusted

³ Response filed October 3, 1984, Item 2, page 2.

Potter's pro forma expense to reflect an allowable expense of \$4,022 for rate-making purposes.⁴

Administrative and Office Expense

Administrative and office expense was \$1,200 for the test period and Potter proposed to increase this amount to \$2,700. The Commission has accepted Potter's inclusion of the following items in determining the appropriate expense level: Rent (\$1,200), Utilities (\$480) and Supplies (\$200).

Potter also proposed to include in its pro forma expense the cost of various office equipment. The Commission is of the opinion that office equipment that can reasonably be expected to have a useful life exceeding 1 year should be capitalized and subsequently expensed over that asset's useful life. Therefore, the Commission has rejected the following proposed expenses: filing cabinet (\$40), typewriter (\$180), and office copier (\$600).

Thus, the Commission has determined the appropriate level of administrative and office expense to be \$1,880.⁵

Interest on Debt

Although Potter had no long-term debt outstanding during the test period, the application proposed pro forma interest

| | | |
|---|------------------------------------|----------------|
| 4 | Pro Forma Expense | \$4,867 |
| | Less: Labor - Capital Improvements | 845 |
| | Allowable Expense | <u>\$4,022</u> |
| 5 | Pro Forma Expense | \$2,700 |
| | Less: Capital Items | 820 |
| | Allowable Expense | <u>\$1,880</u> |

expense of \$400. It was estimated initially that Potter would find it necessary to borrow funds to finance its operating costs. However, on July 6, 1984, Potter withdrew its pro forma interest expense stating that a loan was no longer being considered.⁶ Therefore, no interest expense has been included in adjusted operating costs.

Depreciation

Test period depreciation was \$500 and Potter proposed no adjustment for this expense. However, the Commission is of the opinion that Potter is entitled to depreciation expense on items that should appropriately be accounted for as capital items. Therefore, the Commission has determined that Potter's allowable depreciation expense is \$1,320.⁷

Thus, the Commission has adjusted test period operations as follows:

| | <u>Actual</u> | <u>Adjustments</u> | <u>Adjusted</u> |
|-------------------------|---------------|--------------------|-----------------|
| Operating Revenues | \$7,755 | | \$ 7,755 |
| Operating Expenses | <u>7,677</u> | <u>3,159</u> | <u>10,836</u> |
| Operating Income (Loss) | \$ 78 | \$ <3,159> | \$ <3,081> |

⁶ Response filed July 6, 1984, Item 7, page 6.

⁷ Test Period Depreciation \$ 500
 1983 Capital Items not previously depreciated:
 Water Tanks (\$1,998 ÷ 5 years) 400
 Water Lines
 (Materials [\$974] + Labor [\$845] ÷ 20 years) 91
 Chlorinator (\$1,296 ÷ 5 years) 259
 Typewriter (\$180 ÷ 3 years) 60
 Filing Cabinet (\$40 ÷ 4 years) 10
 Total Allowable Depreciation \$1,320

REVENUE REQUIREMENTS

In determining the revenue requirement in this proceeding, the Commission has used the operating ratio. The Commission is of the opinion that a fair, just, and reasonable operating ratio is 88 percent in that it will permit Potter to meet its operating expenses and provide a reasonable return to its owner. Therefore, the Commission finds that Potter should be permitted to produce an increase in annual revenues of \$4,926⁸ which includes state and federal taxes of \$323.

COMMENTARY

The Commission acknowledges that the revenues allowed herein will result in a substantial increase in customer charges. However, the Commission has found that the necessary increase can be based primarily on the following:

- capital expenditures made in compliance with various regulatory agencies, and
- the need for support personnel to handle an increased workload and to effectively operate a water system of Potter's size.

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 Potter are unfair, unjust, and unreasonable in that they would produce revenues in excess of those found reasonable herein and should be denied.

⁸ (\$10,836 + \$323) = \$11,159 ÷ .88 = \$12,681 - \$7,755 = \$4,926.

2. The rates in Appendix A are the fair, just, and reasonable rates to be charged for water service by Potter in that they will permit Potter to meet its operating expenses and provide a reasonable return to its owners.

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

IT IS FURTHER ORDERED that the rates in Appendix A be and they hereby are the fair, just and reasonable rates for Potter to charge for water service rendered on and after the date of this Order.

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

Done at Frankfort, Kentucky, this 2nd day of November, 1984.

PUBLIC SERVICE COMMISSION

Richard S. Womack
Chairman

Richard S. Womack
Vice Chairman

James Shull
Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION IN CASE NO. 9062 DATED 11/2/84

The following rate is prescribed for the customers in the area served by Roy Potter Water Service. 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.

RATE: Monthly

All Customers

\$23.00