

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF THE ALLEN COUNTY)
WATER DISTRICT, OF ALLEN COUNTY,)
KENTUCKY, FOR APPROVAL OF CONSTRUCTION,) CASE NO. 9304
FINANCING AND INCREASED RATES)

O R D E R

The Allen County Water District ("Allen County") filed an application on March 22, 1985, for approval of adjustments to its water service rates, authorization to construct a \$940,000 waterworks project, and approval of its financing for the proposed project. The project financing includes \$15,000 from the Allen County Fiscal Court, \$45,000 from applicants for service in the proposed project area, a loan of \$444,000 from the Farmers Home Administration ("FmHA") at 7 1/8 percent annual interest, and a grant of \$436,000 from the FmHA. Allen County will issue waterworks revenue bonds as security for the loan. The repayment period for the loan will be 40 years.

The proposed construction will provide service to about 200 applicants for service. Plans and specifications for this construction as prepared by Parrott, Ely and Hurt, Consulting Engineers, of Lexington, Kentucky, ("Engineer") have been approved by the Division of Water of the Natural Resources and Environmental Protection Cabinet.

The proposed rates would produce additional revenue of approximately \$77,131 annually, an increase of 101.6 percent. Based upon the determination herein, the operating revenue of Allen County will increase by \$41,464 annually over normalized test-year operating revenue, an increase of 54.6 percent. This increase does not include a \$32,464 increase in revenues due to the addition of approximately 200 customers and normalization of the test-year operating revenues.

A hearing was held in the offices of the Public Service Commission, Frankfort, Kentucky, on June 27, 1985. There were no intervenors; however, the Commission received 14 letters and 3 petitions of protest concerning the proposed adjustments to its water service rates.

Dr. William Jenkins, who performed the financial calculations of the rate case, was unable to attend the hearing due to illness. At the hearing, certain requests for additional information were made. This information has been filed.

COMMENTARY

Allen County is a water district organized and existing under the laws of the Commonwealth of Kentucky and currently serves 310 customers in Allen County, Kentucky. The proposed extension will increase the number of customers served by Allen County to approximately 510.

CONTINUITY OF ADEQUATE AND RELIABLE SERVICE

Allen County's Engineer has provided information and testimony which appear to indicate that reliable and adequate service can be maintained throughout the expanded system after

completion of the proposed construction. The Commission is concerned, however, that Allen County's service to its customers in the higher elevations of its service area may not be totally adequate in the long term.

The Commission reminds Allen County of its obligation to provide adequate and reliable service to all of its customers. Allen County should monitor the adequacy of the expanded water distribution system after construction. If this monitoring indicates that the level of service is inadequate or declining, Allen County must take necessary actions to maintain the level of service in conformance with the regulations of this Commission.

TEST PERIOD

Allen County has proposed and the Commission has accepted the 12-month period ending December 31, 1984, as the test period for determining the reasonableness of the proposed rates. In utilizing the historical test period, the Commission has given full consideration to known and measurable changes found reasonable.

REVENUES AND EXPENSES

Allen County proposed adjustments to revenues and expenses as reflected in the Comparative Income Statement filed in the application as Appendix A. The Commission is of the opinion that the proposed adjustments are generally proper and acceptable for rate-making purposes with the following modifications to reflect actual and anticipated operating conditions:

Wages and Salaries

Allen County proposed several adjustments to the wages and salaries of its employees. The justification Allen County provided for the \$13,800 increase in the manager's salary was a survey performed by the Kentucky Rural Water Association which shows the average salary of water system managers as beginners to be \$14,836, and experienced to be \$15,365.¹ Allen County recommended a salary of \$15,000 based upon the fact that the manager has 4 years of experience. Currently, the manager, Mr. O. T. Yates, earns an administrative stipend of \$100 a month plus \$5.00 per hour. During the test period, Mr. Yates earned \$6,016: \$1,200 manager's fee, plus \$4,816 for 1,204 hours at \$4.00 per hour. It is the Commission's opinion that comparing Allen County's part-time manager's position compensation to a full-time manager's compensation is unjustifiable. Allen County provided no additional support for the increase in salary to the manager. Thus the proposed adjustment has not been included herein. However, an adjustment has been made to allow for the increase in the per hour compensation for the manager from \$4.00 to \$5.00 per hour. Therefore, an additional \$1,204 has been included herein for the manager's salary.

Allen County proposed a new position titled "Maintenance/Meter Reader" which would combine tasks previously performed by the manager and several others. The proposed position is

¹ Response, Commission's Information Request of June 18, 1985, Item No. 5.

considered by Allen County to be comparable with the County Road Supervisor of Allen County. The proposed salary of the Maintenance/Meter Reader was set at the rate of the County Road Supervisor, which is \$12,000. Five people currently perform these duties on a part-time basis. The total of the test-year expenses for the manager, meter reader and operation labor was \$13,722. Under the proposed reorganization, the same expenses would total \$18,094. This proposed adjustment has not been shown to be associated with the proposed additional customers. Another method that could be initiated would be to keep a part-time manager and hire a "Maintenance/Meter Reader," as it has not been shown that a full-time manager is needed. Since Allen County provided inadequate responses to the Commission's Information Request of June 18, 1985, and Allen County presented no witness at the hearing to reinforce its adjustment, it is the Commission's opinion that Allen County should maintain the current organizational structure. The proposed change has not been proven to be more economical or efficient with regards to the operations of Allen County. Therefore, the Commission has not made an adjustment to increase the meter reading labor based on the comparative proposal. An adjustment has been allowed, however, for the annualization of the rate change by the Allen County Fiscal Court for skilled workers. This affected one employee, Bobby Ashford, whose hourly rate changed from \$5.75 an hour to \$6.25 during the test period. Therefore, an additional \$191 has been included herein for the maintenance labor expense for rate-making purposes.

Allen County proposed an adjustment to the wages of the secretary-clerk position based upon the additional customers. Even though an increase in duties is probably to be expected, the adjusted amount cannot be deemed to be known and measurable. Allen County has proposed that a part-time secretary/clerk will be needed at \$5.00 per hour. The present secretary/clerk earns \$75.00 per month. It is the Commission's opinion that the proposed adjustment of \$4,300 to the secretary/clerk position is not justifiable and, therefore, is hereby denied.

Purchased Water Expense

Allen County proposed an adjustment to the purchased water expense based upon the additional customers to be added in expansion. The method used by Allen County to compute the adjusted amount was to calculate a per-customer cost based on 1985 estimated consumption, excluding the sales to the Corps of Engineers, a large user, and pro rate the amount to include the additional customers. It is the Commission's opinion that the methodology used for determining the adjusted amount is appropriate; however, the actual test-year consumption should be used as the basis for the adjustment instead of the 1985 budgeted amount, since the test-year actual consumption is known and measurable. Thus, the adjusted purchased water expense proposed by Allen County has been increased by \$8,060.

Equipment Rental Expense

Allen County entered into a lease agreement with Case Power & Equipment on September 17, 1984, to lease a loader/backhoe. The lease is for a period of 4 years and Allen County takes possession

of the loader/backhoe at the end of the lease. Allen County is currently considering the agreement an operating lease by expensing the monthly lease payments of \$813. The original cost of the loader/back-hoe was \$33,538 and, over the 4 years, Allen County will pay a total of \$39,040. The Commission is of the opinion that this arrangement under generally accepted accounting practices should be treated as a capital lease agreement and, therefore, the loader/backhoe should be capitalized and depreciated over a useful life of 10 years. Thus, the \$3,253 equipment rental expense has been excluded from operating expense for rate-making purposes. As a result of capitalizing the loader/hackhoe, the total depreciation expense has been increased by \$3,354 in addition to increasing the test-year interest expense by \$1,154 due to the 4-year averaged interest expense associated with the financing agreement.

Office Supplies and Other Expenses

Allen County proposed to increase Office Supplies and Other Expenses by \$1,221 based upon the additional customers. The Barren River Development Council performs the billing function for Allen County on a per bill basis. During the test year, the cost was \$.29 per bill. However, effective with the July, 1985, billings, the cost will be \$.34 per bill because the Barren River Development Council will begin separating and mailing the bills, functions previously performed by Allen County. This increase in costs, including the costs for the additional customers, amounts to \$998. Allen County's justification for the additional \$223 adjustment is that the expansion of services will add to supply

costs. Even though it can be expected that some additional costs due to the expansion will occur, the amount is not known or measurable. Therefore, it is the Commission's opinion that the increased amount due to the change in service by the Barren River Development Council should be allowed, but the additional proposed amount due to the expansion should be denied. Thus, the Office Supplies and Other Expenses has been increased by \$998.

Transportation Expense

Allen County's Transportation Expense is comprised of two items: gas and oil purchased for the truck owned by Allen County, and reimbursements to employees for use of their own vehicles at \$.20 per mile. Allen County proposed to increase the 1985 budgeted amounts of both of these items using the ratio of existing customers to the total customers after the expansion. In projecting the expected transportation expense the historical test-year amount should be used as the basis to calculate the adjustment instead of the budgeted 1985 amount, since the test-year amount is known and measurable. It is apparent that the transportation expense will increase due to the meter readings of the additional customers. The Commission is of the opinion that there is no direct relationship between the number of customers added and the meter reading transportation expense, since the customer density will be much less for the expanded system. However, since the Commission recognizes that there will be increased costs and no alternative methods are contained in the record in this case, the Commission will include, using historical test-year data, an adjustment recognizing that this will be a

conservative projection of this expense. However, the adjustment to the truck expenses for gas and oil have not been included because the percentage increase in these expenses cannot be directly related to the increase in customers and thus is not known and measurable. Therefore, the Transportation Expense has been increased by \$1,646 for rate-making purposes.

Depreciation Expense

Allen County proposed an adjustment to the Depreciation Expense to include depreciation on the proposed extension financed with non-contributed property. The adjustment is \$11,100, based upon a 2.5 percent depreciation rate on the capital investment secured through the \$444,000 bond issuance. The Commission is of the opinion that this adjustment is reasonable and justified.

Allen County, however, was not consistent in adjusting the test-year depreciation for existing contributed property for rate-making purposes. The Commission is of the opinion that such an adjustment is justifiable and, therefore, has decreased the test-year depreciation expense by the percentage of contributed property to the total plant cost.

In addition, the total depreciation expense has been increased by \$3,354 due to the capitalization of the loader/backhoe. Therefore, the net effect of the aforesaid adjustments results in an increase to depreciation expense of \$3,452.

Accounting and Collecting Labor

Allen County pays a bookkeeping service \$100 a month for preparing monthly financial statements and \$300 a year for preparing the PSC Annual Report. In addition, Allen County has this

firm perform other routine functions such as preparation of W-2 forms, 1099 forms, and recording right-of-way easements. Allen County has proposed adjustments to these expenses based upon the percentage of increase in customers. It is the Commission's opinion that these expenses are not directly related to the increase in customers. Since the proposed adjusted amount is not known or measurable, the adjustment has been denied.

The test-year accounting expense included a year-end adjustment of \$200 which made the total monthly payments for the year \$1,400. The Commission is of the opinion that Allen County's proposal to reduce the actual test-year bookkeeping fees by \$200 is reasonable and should be included herein for rate-making purposes. Therefore, the Accounting Expense has been reduced by \$200.

Rate Case Expense

Allen County did not propose an adjustment to include the amortization of the Rate Case Expense. It is the Commission's opinion that this cost is justifiable, known and measurable. The total rate case expense is \$5,991 and should be amortized over a 3-year period. Therefore, a Rate Case Expense of \$1,997 annually for 3 years has been added to the total operating expenses for rate-making purposes.

Other Operating Expenses

Allen County proposed adjustments to the Maintenance of Mains Expense and the Operation Supplies and Maintenance Expense based upon the percentage of increase in customers, which was applied to the 1985 budgeted amount. The Commission is of the

opinion that these expenses are not directly related to the percentage of increase in customers. In response to information requests regarding these adjustments, Allen County provided no further support for this methodology or the adjusted amount. A new facility such as the proposed extension should only require minimal maintenance. Thus, the proposed adjustments made by Allen County have not been included herein.

Both the Maintenance of Mains expense and the Operation Supplies and Maintenance Expense included some amounts paid to a local plumbing company for backhoe work performed for Allen County before Allen County acquired its backhoe. It is the Commission's opinion that these amounts should be excluded from the test-year based upon the fact that these expenses will not be incurred in the future. Therefore, \$150 has been excluded from these accounts for rate-making purposes.

Uncollectibles

Allen County has proposed an adjustment to the Uncollectible Expense of \$375, approximately double the test-year expense. Allen County stated in its response to the Commission's Information Request of June 18, 1985, "The figure estimated here is just that, an estimate or a guess. Bad debts are anticipated to be slightly twice that of the test year."² The account balance has been very inconsistent during the past 4 years as evidenced by the fact the 1982 balance was \$935, the 1983 balance was \$0, and the test-year balance was \$348. It is the Commission's

² Response, Commission's Order dated June 18, 1985, Item No. 11.

opinion that a known and measurable adjustment cannot be made to this account based upon the aforementioned items. Therefore, the adjustment proposed by Allen County for the Uncollectibles Expense has not been included for rate-making purposes.

Miscellaneous, General Expense

Allen County proposed an adjustment to the Miscellaneous, General Expense based upon the 1985 budgeted amount. The Commission is of the opinion that the historical test-year amounts should be used for projecting expenses. Allen County did not provide any further information for the adjustment except for the 1985 budgeted amount. Therefore, since the amount of the adjustment is not considered to be known and measurable, the proposed adjustment to the Miscellaneous, General Expense is hereby denied.

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

	<u>Actual Test Period</u>	<u>Adjustments to Test Period</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$ 43,476	\$ 32,464	\$ 75,940
Operating Expenses	54,981	21,773	76,754
Net Operating Income	<u>\$ <11,505></u>	<u>\$ 10,691</u>	<u>\$ <814></u>
Other Income	4,732	-0-	4,732
Other Deductions	3,190	32,133	35,323
Net Income (Loss)	<u><u>\$ <9,963></u></u>	<u><u>\$ <21,442></u></u>	<u><u>\$ <31,405></u></u>

REVENUE REQUIREMENTS

The Commission is of the opinion that the adjusted test-period operating loss is clearly unjust and unreasonable.

Pursuant to Allen County's bond indentures, Allen County is required to have sufficient revenues to meet the operating expenses and maintain a 1.2X debt service coverage. The Commission finds this method to be a fair, just and reasonable method of determining revenue requirements in this case and adequate enough to allow Allen County to pay its operating expenses, meet its debt service requirements and maintain a reasonable surplus. Therefore, the Commission finds that Allen County is entitled to an increase in annual revenues of \$73,928, including a \$32,464 increase due to additional customers.

RATE DESIGN

Allen County's current rate design consists of three rate schedules. The rate schedule for general customers contains four rate steps ranging from minimum usage of 2,000 gallons to an over 10,000 gallon category. The rate schedules for the Corps of Engineers and Pardue Mobile homes consist of two rate steps allowing 118,000 and 14,000 gallons or less, respectively, for the minimum bill amounts and usage over the minimum at the same rate as the lowest general customer rate step.

Allen County proposed to change its rate design by adding additional steps to its rate schedules and lowering the minimum usage levels for the Corps of Engineers to 55,000 gallons and Pardue Mobile Homes to 10,000 gallons. Usage in excess of the minimum would be billed in accordance with the general rate schedule.

In support of the proposed change, Allen County stated, in Exhibit XIX to the response filed June 24, 1985: (1) large, single

meter users would be greatly impacted by the proposed rate increase; (2) large users are less costly to serve on the basis of the volume per connection (3) the additional rate steps might make the District's service more attractive to prospective industrial, commercial and farming customers. In addition, the Commission notes that the proposed changes more closely follow the usage patterns of Allen County's customers and allows a more equitable distribution of the increase granted herein.

The Commission is, therefore of the opinion that the proposed change in rate design is fair, just, and reasonable and will benefit Allen County and its customers.

FINDINGS AND ORDERS

The 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 project for the Allen County water system includes a 164,500-gallon water storage tank, 200 service connections, about 19.9 miles of 8-, 6-, and 4-inch water main and miscellaneous appurtenances.

3. The low bids received for the proposed construction totaled \$654,470, which will require about \$940,000 in project funding after allowances are made for fees, contingencies, other

indirect costs and additional construction being considered as a result of receiving bids under the final estimate.

4. 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.

5. Allen County should obtain approval from the Commission prior to performing any additional construction not expressly certificated by this Order.

6. Allen County should file with the Commission duly verified documentation which shows the total costs of construction including all capitalized costs (engineering, legal, administrative, etc.) within 60 days of the date that construction is substantially completed. The construction costs should be classified into appropriate plant accounts in accordance with the Uniform System of Accounts for Water Utilities prescribed by this Commission.

7. Allen County's contract with its Engineer should require the provision of full-time resident inspection under the general supervision of a professional engineer with a Kentucky registration in civil or mechanical engineering. The 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.

8. Allen County 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.

9. A 5/8-inch x 3/4-inch meter should be the standard customer service meter for all new customers and should be installed at all points of service unless the customer provides sufficient justification for the installation of a larger meter.

10. Allen County 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.

11. The proposed borrowing of \$444,000 is for lawful objects within the corporate purposes of Allen County, is necessary and appropriate for and consistent with the proper performance of services to the public by Allen County, and will not impair its ability to perform these services.

12. The financing secured by Allen County for this project will be needed to pay for the work herein approved. Allen County's financing plan should, therefore, be approved.

13. The rates in Appendix A are fair, just and reasonable rates for Allen County and will produce annual water revenue of approximately \$117,115. This revenue, when combined with other operating revenue of \$289 and other income of \$4,732 will be sufficient to allow Allen County to pay its allowable operating costs, service its debt and provide a reasonable surplus.

14. The rates proposed by Allen County would produce revenue in excess of that found reasonable herein and, therefore, should be denied upon application of KRS 278.030.

15. The change in rate design proposed by Allen County is fair, just, and reasonable and should be approved.

IT IS THEREFORE ORDERED that Allen County be and it hereby is granted a certificate of public convenience and necessity to proceed with the waterworks construction projects described by the plans and specifications of record herein approved.

IT IS FURTHER ORDERED that Allen County shall comply with Findings 4 through 10 and 12 herein as if each of these findings were also ordered.

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

IT IS FURTHER ORDERED that the proposed change in rate design be and it hereby is approved, effective for services rendered on and after the date of this Order.

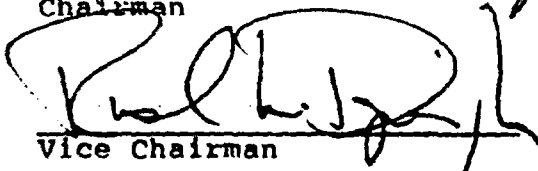
IT IS FURTHER ORDERED that within 30 days from the date of this Order Allen County shall file with the Commission the revised tariff sheets setting out the rates approved herein.

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 26th day of July, 1985.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman

~~not participating~~
Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 9304 DATED JULY 26, 1985

The following rates and charges are prescribed for customers receiving water service from Allen County Water District. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

GENERAL CUSTOMERS

<u>Usage Block</u>	<u>Monthly Rates</u>
First 2,000 gallons	\$ 11.75 Minimum
Next 3,000 gallons	4.20 per 1,000 gallons
Next 5,000 gallons	3.35 per 1,000 gallons
Next 60,000 gallons	2.90 per 1,000 gallons
Over 70,000 gallons	2.50 per 1,000 gallons

CORPS OF ENGINEERS

<u>Usage Block</u>	<u>Monthly Rate</u>
First 55,000 gallons	\$ 220.00 Minimum
Next 15,000 gallons	2.90 per 1,000 gallons
Over 70,000 gallons	2.50 per 1,000 gallons

PARDUE MOBILE HOMES

First 10,000 gallons	\$ 41.10 Minimum
Next 60,000 gallons	2.90 per 1,000 gallons
Over 70,000 gallons	2.50 per 1,000 gallons