

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

AN ADJUSTMENT OF RATES OF THE )  
AUXIER WATER COMPANY, INC. ) CASE NO. 9308

O R D E R

On March 27, 1985, the Auxier Water Company, Inc., ("Auxier Water") filed an application with the Commission seeking approval of proposed adjustments to its existing rates and charges for providing water service. On May 23, 1985, Auxier Water filed a motion to file an amended application which contained substantial increases and changes to test year expenses. Auxier Water further stated that the proposed rates would become effective on and after June 18, 1985, whereas the original application gave no effective date.

The Commission, in its Order of June 17, 1985, granted Auxier Water's motion of May 23, 1985, which changed the filing date of the application from March 27, 1985, to May 23, 1985, and it also suspended the proposed rates as set out in Auxier Water's amended application for a period of 5 months beginning on June 18, 1985.

A public hearing was held in this matter on September 4, 1985, in the Commission's offices in Frankfort, Kentucky. The Attorney General and the Auxier Community Development Club intervened and participated in the hearing.

All additional information which was requested at the hearing has been filed, and the entire matter is now submitted for final determination by the Commission.

The proposed rates would produce an increase in gross annual revenues of approximately \$65,993 or 35.5 percent above adjusted test period revenues. In this Order, the Commission has approved rates which will produce an annual increase of \$35,280.

#### TEST PERIOD

Auxier Water proposed and the Commission has accepted the 12-month period ending December 31, 1984, as the test period in this matter.

#### REVENUES AND EXPENSES

Auxier Water incurred a net loss for the test period of \$20,100. To more accurately reflect current operating conditions, Auxier Water proposed several pro forma adjustments to its test period operating revenues and expenses. The Commission finds these adjustments reasonable and has accepted them for rate-making purposes with the following exceptions:

##### Operating Revenues

Auxier Water showed test period operating revenues of \$172,064 from the sale of water to its 580 customers. The billing analysis of Auxier Water (appearing as Exhibit No. 12 of its amended application) showed year-end water sales under existing rates, as prescribed by the Commission's Order in Case No. 9015,<sup>1</sup>

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<sup>1</sup> The Application of Auxier Water Company, Inc., for an Adjustment of Rates Pursuant to the Alternative Procedure for Small Utilities, Order entered July 13, 1984.

of \$186,114. Thus, the Commission has increased test period revenues from water sales by \$14,050. When the proposed rates of Auxier Water were applied to its billing analysis the result was pro forma water sales of \$252,107 or an increase of \$65,993.

Transmission and Distribution Expense-Operation Supervision

Auxier Water's general manager's salary for the test period was \$20,500. Auxier Water proposed to increase the general manager's salary \$3,500. During the hearing, Mr. Philip Ward, the general manager, testified that his duties include work performed in several areas of the water system such as new construction, general maintenance, finance and various other duties as needed to provide adequate water service for Auxier Water's customers.<sup>2</sup>

In the past two rate cases the Commission allowed general manager's salary of \$12,000 and \$14,323, respectively, and reduced the actual salary paid by Auxier Water to grant only increases in the inflation level measured by the Consumer Price Index ("CPI"). With the new evidence in this case, the Commission is persuaded that the general manager's duties should be compensated greater than the change in the CPI and has allowed the test-period salary paid of \$20,500. However, the Commission is of the opinion that Auxier Water has not presented sufficient evidence to warrant an increase above the test period level since the duties performed by the general manager during the test period have not changed.

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<sup>2</sup> Transcript of Evidence ("T.E."), September 4, 1985, Pgs. 31-34.

Therefore, the Commission has denied the proposed increase of \$3,500.

Meter Expenses

Auxier Water had recorded meter expenses for the test period of \$1,870. An examination of individual invoices attached to Auxier Water's check no. 1648 showed there were charges of \$56 for items purchased outside the test period. Therefore, the Commission has reduced meter expenses by \$56.

Outside Services Employed

Auxier Water included \$3,150 in test year expenses for legal and accounting services rendered to Auxier Water. Auxier Water's response to the Commission's request for additional information received July 22, 1985, indicates that \$625 was paid for legal services in connection with Auxier Water's application for the Small Business Administration ("SBA") loan. The record indicates that the funds from the SBA loan were used in the replacement of the washed-out river crossings water lines. The Commission considers the legal fees of \$625 to be a portion of the capital construction cost of the river crossings and has transferred this cost to the depreciation expense section of the Order for proper consideration. Therefore, the adjusted test period expense related to Outside Services Employed is \$2,525.

Transportation Expenses

Auxier Water had recorded transportation expense of \$4,355 related to the operation and maintenance of its work vehicles during the test period. The Commission has made an inter-account adjustment transferring \$858 from the repairs and maintenance

expense account to transportation expense, which represents payment for tires and brake repairs to company owned vehicles for proper identification. Auxier Water indicated that check no. 1314, dated February 22, 1984, to Davis Produce for \$358, included an out-of-period purchase of gasoline in the amount of \$194. Auxier also advised the Commission in its response that check no. 1561 dated August 23, 1984, to Ashland Petroleum in the amount of \$564, was a duplicate payment and payment of the check had been stopped. The Commission has made a downward adjustment totalling \$758.

During the hearing, Mr. Ward was advised that the Commission had made a comparative analysis of transportation expense between the test period and the 2 years preceding, 1982 and 1983, and found a substantial increase in cost during the test period; and questioned if it was the result of increased construction during 1984. On cross-examination, Mr. Ward, stated that 40 to 50 percent of transportation expense could be considered a portion of the capital cost of construction during 1984.<sup>3</sup> The Commission has used 40 percent as the factor and has reduced transportation expense by \$1,782. These expenses will be discussed further in the section on depreciation expense.

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<sup>3</sup> T.E., September 4, 1985, p. 120.

Therefore, the Commission finds the adjusted transportation expense for rate-making purposes is \$2,673.<sup>4</sup>

Repairs and Maintenance

Auxier Water showed a special account entitled repairs and maintenance expense with a test period total of \$3,624. In response to the Commission's request for information, filed on July 22, 1985, an analysis was filed indicating that during the test period Auxier Water made the following plant additions, but erroneously charged them to repairs and maintenance expense:

Check No. 1485 dated 7-11-84 to Patco, Inc., fence \$ 318  
for the filter plant-

Check No. 298 dated 6-6-84 to Trans Sales for an air 700  
compressor-

Check No. 311 dated 6-23-84 to Marshall Ward for 547  
rebuilding backhoe transmission-

Auxier Water concurred with the Commission's position on the first two items during cross-examination.<sup>5</sup>

Although Auxier Water disagreed with the Commission on the third item, the Commission is still of the opinion that this item

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<sup>4</sup> Computation of Transportation Expense:

Transportation expense, per books 12/31/84	\$ 4,355
Add:	
Vehicle expense erroneously charged to Repairs & Maint.	858
Deduct:	
1983 gasoline purchased out of test period	(194)
Ashland Petroleum ck. no. 1561 cancelled by Auxier Water	(564)
Capital portion transferred to depreciation expense	(1,782)
Adjusted Transportation Expense	<u>\$ 2,673</u>

<sup>5</sup> T.E., September 4, 1985, pgs. 112-113 and 148.

represents an improvement to the equipment and would extend the life of the asset beyond one period.

Moreover, an inter-account transfer of \$858 for vehicle expense, which should have been charged to transportation expense, has been made by the Commission in an earlier section of this Order. The account was further reduced by \$200 through various petty cash purchases made in 1985. Therefore, test period expenses related to repairs and maintenance expense have been reduced by \$2,623, which results in adjusted repairs and maintenance expense of \$1,001.<sup>6</sup>

#### Depreciation Expense

Auxier Water projected pro forma depreciation expense for the test period of \$21,301 as shown on revised Exhibit No. 7, annual depreciation allowance. The Commission in its disallowance of capital items of \$1,565 included in the cost of repairs and maintenance expense, attorney fees of \$625, and transportation expense of \$1,782 has allowed a pro forma depreciation expense adjustment of \$794 computed on the basis of an average 5-year life the Commission finds reasonable.

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<sup>6</sup> Computation of Repairs and Maintenance Expense:

Repairs and maintenance expense, per books, 12-31-85	\$ 3,624
Capital items transferred to depreciation expense section	(1,565)
Inter-account transfer to transportation expense	(858)
1985 out of test period purchases through petty cash	<u>(200)</u>
Adjusted repairs and maintenance expense	<u>\$ 1,001</u>

Auxier Water's composite depreciation rate for plant in service was 5 percent.<sup>7</sup> The Commission has also reduced depreciation expense by \$2,478, in accordance with its established practice that depreciation expense should be computed on the basis of original cost of the plant in service less contributions in aid of construction. The Commission is of the opinion that it is unfair to require ratepayers to provide recovery on that portion of the plant provided free of cost.

The Commission is further of the opinion that the write-off period on the unrecovered cost of the river crossings of \$11,795 should be extended from 3 to 5 years. Thus, the Commission finds that the appropriate adjusted test period depreciation expense is \$21,976.<sup>8</sup>

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<sup>7</sup> 
$$\frac{\text{Test period depreciation}}{\text{Gross plant less land}} = \frac{\$ 17,369}{\$347,368} = 5\% \text{ (Composite Rate)}$$

<sup>8</sup> Computation of allowable depreciation expense:

Depreciation Expense, per books adjusted, 12-31-84	\$21,301
Add:	
Depreciation expense on capital items transferred from Repairs & Maintenance, Outside Services and transportation expense - \$3,972 ÷ 5 years =	794
Adjustment based on extending write-off period from 3 to 5 years concerning the unrecovered cost of the river crossings - \$11,795 ÷ 5 years =	2,359
Less:	
Depreciation expense on contributions in aid of construction of \$49,560 X 5 percent composite rate =	(2,478)
Total allowable depreciation expense	<u>\$21,976</u>



### Payroll Taxes

At the end of the test period, Auxier Water had recorded payroll taxes of \$3,934, and made a pro forma adjustment of \$390 computed on the basis of salary increases proposed for the general manager and another employee. The Commission, in another section of this Order, denied the increase in the general manager's salary and has concurrently reduced social security taxes \$247.<sup>9</sup> The Commission has also disallowed the unemployment insurance of \$70 that was proposed by Auxier Water on the salary increase of the other employee. This was done on the basis that the tax is paid only on the first \$7,000 of wages paid to an employee during the calendar year. The other employee's salary for 1984 was \$10,312. Therefore, the Commission has reduced payroll taxes by \$317 from test period operating expenses.

### Prior Year Taxes

Taxes of \$201 for a year prior to the test period were paid by Auxier Water to the Kentucky State Treasurer. These taxes are not an operating expense of the test period and must be deducted from the test period to reflect the ongoing annual level of taxes for rate-making purposes.

### Rate Case Expense

Auxier Water proposed a pro forma adjustment of \$3,366 to reflect a 3-year amortization of the \$11,550 estimated cost of

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<sup>9</sup>  $\$24,000 - \$20,500 = \$3,500 \times .0705 = \$247.$

this rate case, as shown on Exhibit No. 9 of the amended application. During the public hearing, Auxier Water was directed to furnish the Commission with the actual cost of each service performed included in the rate case expense. After reviewing the information filed September 11, 1985, the Commission bases its computation on the amounts contained in the record: Attorney \$5,093, Engineer \$2,294, Accountant \$1,446 and advertising of \$150, totalling \$8,983 or an annual amortization of \$2,994 over a 3-year period. Thus, the Commission has reduced rate case amortization by \$372.

#### Interest on Long Term Debt

Auxier Water projected total interest expense of \$10,952 of which \$1,305 represents pro forma interest expense related to borrowing funds for rate case cost. At the time of the hearing, Auxier Water had not borrowed any funds specifically for payment of rate case expenses. Therefore, the Commission has denied the inclusion of pro forma interest of \$1,305 related to rate case expense for rate-making purposes.

#### Income Taxes

Auxier Water projected pro forma federal and state corporate income taxes of \$7,354 for the test period. The Commission is of the opinion that the federal and state corporate income taxes should be allowed for rate-making purposes, and the computation will be made in a later section of this Order. Therefore, Auxier Water's pro forma taxes have been eliminated.

Therefore, Auxier Water's adjusted operations at the end of the test period are as follows:

	<u>Auxier Water Adjusted</u>	<u>Commission Adjustments</u>	<u>Commission Adjusted</u>
Operating Revenues	\$ 190,426		\$ 190,426
Operating Expenses	211,150	<16,055>	195,095
Net Operating Income	<u>\$ (20,724)</u>	<u>\$ 16,055</u>	<u>\$ &lt;4,669&gt;</u>
Interest Expense	10,952	(1,305)	9,647
Net Income	<u>\$ (31,676)</u>	<u>\$ 17,360</u>	<u>\$ (14,316)</u>

#### REVENUE REQUIREMENTS

The Commission is of the opinion that Auxier Water's adjusted net loss of \$11,640 is unfair, unjust and unreasonable. The Commission in determining Auxier Water's revenue requirement has considered numerous alternatives including rate of return, debt service coverage, and operating ratio methods. Auxier Water, in the preparation of its amended rate application filed on May 23, 1985, used an operating ratio of 88 percent as shown on Exhibit No. 10. The Commission is further of the opinion that the operating ratio method is an appropriate method of determining revenue requirements in this instance as it will permit Auxier Water to pay its operating expenses, service its debt, and provide a reasonable return to its stockholders.

However, the Commission finds that an operating ratio of 88 percent is excessive and produces net income greater than that found fair, just and reasonable. The Commission is further of the

opinion that a fair, just and reasonable operating ratio is 92 percent in this instance in that the revenue produced should provide sufficient revenues for Auxier Water to pay its operating expenses and provide a reasonable surplus for equity growth.

Therefore, the Commission is of the opinion that Auxier Water is entitled to increase its rates to produce an increase in annual revenue of \$35,280<sup>10</sup> which produces net income of \$17,285, including a provision for federal and state income tax expense of \$3,679.<sup>11</sup>

#### 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 Auxier Water would produce revenues in excess of the revenues found reasonable herein and should be denied pursuant to KRS 278.030.

2. The rates in Appendix A are the fair, just and reasonable rates to charge for water service rendered to Auxier Water's customers and should produce annual revenues from water sales of approximately \$221,394.

3. Auxier Water 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.

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<sup>10</sup>  $\$198,774 \times .92 = \$216,059 + \$9,647 - \$190,426 = \$35,280.$

<sup>11</sup> Taxable income X composite federal and state tax rate:  
 $\$17,285 + \$3,679 = \$20,964 \times 17.55 \text{ percent} = \$3,679.$

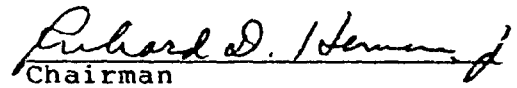
IT IS THEREFORE ORDERED that:

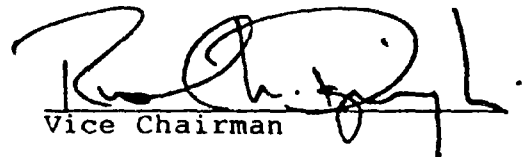
1. The rates in Appendix A be and they hereby are approved as the fair, just and reasonable rates to be charged by Auxier Water for water service rendered on and after the date of this Order.

2. Within 30 days of the date of this Order Auxier Water 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 15th day of November, 1985.

PUBLIC SERVICE COMMISSION

  
Chairman

  
Vice Chairman

  
Commissioner

ATTEST:

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Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 9308 DATED 11/15/85

The following rates and charges are prescribed for the customers receiving water service from Auxier Water Company, Inc. 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.

<u>Monthly Charges</u>	<u>Rate</u>
First 1,000	\$8.30 Minimum Bill
Next 1,000	4.60 per 1,000 gallons
Next 6,000	3.95 per 1,000 gallons
Next 6,000	3.20 per 1,000 gallons
Next 14,000	2.55 per 1,000 gallons