

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF ELAM UTILITY)
COMPANY FOR A GENERAL INCREASE) CASE NO. 9375
IN RATES)

O R D E R

On January 31, 1986, Elam Utility Company ("Elam") filed an application for rehearing in this matter wherein it objected to several issues in the Commission's Order of January 13, 1986. Elam requested rehearing on the issues of wage and salary adjustments of \$2,139; a weather normalization adjustment of \$2,937; a reduction of long-term capitalization of \$205,980; a reduction of interest expense of \$4,883; no consideration of \$11,572 in annual principal payments; the rate base; the rate of return; no consideration of alternative methods of revenue determination; and the rates of return.

Wages and Salaries

Elam objected to the denial of an adjustment of \$2,139 to wages and salaries which it proposed at the public hearing in this case. The Order of January 13, 1986, denied this adjustment on the grounds that the adjustment was filed too late to afford the Commission the opportunity to determine its reasonableness.

Elam initially proposed a wage and salary increase of \$1,779 annually which was a 2.8 percent increase above previous salaries and in line with current inflation levels. The proposed

additional increase of \$2,138 annually would have resulted in an increase of 6.3 percent above the previous adjusted amount; thus, the basic nature of the wage and salary adjustment changed from a mere price level increase to an increase in wages and salaries, which should be either commensurate with additional duties or an increase in productivity. No evidence was offered to support either case. Therefore, rehearing on this issue should be denied.

Temperature Normalization

In its application for rehearing, Elam objected to the denial of a proposed adjustment of \$2,937 to normalize revenues for temperature variation. To make a normalized temperature adjustment, certain factors must be carefully coordinated. At a minimum, Elam needed to determine and consider: base load per customer class; the current price of purchases and sales; the lost sales due to normalization; and determine that the temperature measurements are relevant to the area and time period served. Elam offered no documentation of any of these factors. The Commission is of the opinion that Elam has failed to meet its burden of proof in regard to the temperature normalization adjustment. Therefore, rehearing of this issue is denied.

Long-term Capitalization

Elam objected to the reduction of long-term capitalization by \$205,980, the amount by which capitalization exceeded rate base. Elam believes that the reduction in total capitalization produced a revenue shortfall of \$10,557 due to interest expense.

By reducing total capitalization and thus synchronizing interest expense with rate base, the Order of January 13, 1986,

did not have the effect of disallowing the funding of interest expense. In determining the rate of return on rate base at 237.5 basis points above the actual cost of capitalization, the obligation of the ratepayers and the cost of capitalization to be borne by the stockholders of the utility was established and a reasonable surplus was provided for equity growth. Therefore, the Order of January 13, 1986, did not deny the funding of any long-term capitalization, but merely emphasized a proper accounting of net operating income. Consequently, rehearing on this issue should be denied.

Interest Expense

Elam objected to the disallowance of \$4,883 of interest expense associated with past due gas purchases, reasoning that it does not eliminate the obligation.

The \$4,883 in interest expense was associated with \$57,617 of past due gas purchases owed Columbia Transmission which Elam proposed to amortize at \$28,807 annually for rate-making purposes. The Order of January 13, 1986, disallowed the amortization of past due gas purchases on the grounds of double cost recovery. To be consistent with the disallowed amortization and on the same basis of double recovery, the Order also disallowed the interest expense on the past due gas purchases.

On review, the Commission is of the opinion that its decision to disallow interest expense associated with past due gas purchases is based on sound and consistent rate-making practice.

Elam has not offered any new evidence for reconsideration which alters the Commission's decision. Therefore, rehearing on this issue should be denied.

Principal Payments

Elam objected to the lack of reference made to approximately \$11,572 in annual principal payments in the Order of January 13, 1986. In establishing the reasonable revenue requirements the Commission provides for reasonable operating costs and provides a reasonable rate of return. The Order allowed depreciation expense of \$19,759 annually and amortization of abandoned plant of \$4,884 annually for rate-making purposes which provide sufficient cash flow to repay the principal on Elam's outstanding debt.

Therefore, the recapture of invested capital was fully considered and contained within the Order of January 13, 1986. Consequently, rehearing on this issue should be denied.

Rate Base and Rate of Return

In its application for rehearing, Elam stated that a meaningless, unnecessary and confiscatory rate base was computed. Elam further stated that a meaningless, unnecessary and confiscatory rate of return was applied to the confiscatory rate base.

There is no discussion in Elam's application as to why each of these issues is meaningless, unnecessary or confiscatory. It is a common rate-making practice to determine a reasonable return on rate base as was done in this case. Therefore, rehearing on these issues should be denied.

Alternative Methods of Revenue Determination

Elam objected to the failure to consider basing Elam's revenue requirements on a 1.2X debt service coverage ("DSC") or a .88 operating ratio. Elam asserted that failure of the Commission to even comment on these issues is tantamount to denial of equal protection of the laws.

In a review of the evidence of record the Commission could not find where these alternative methods of revenue determination were actually proposed as adjustments to Elam's revenue requirements. However, the Commission did find where Elam offered these methods to show that Elam's revenue requirements would be higher if a .88 operating ratio or a 1.2X DSC were used. The Commission viewed the alternative calculations of revenue requirements as advisory and did not consider them as formal adjustments since the record clearly reflects the nature of the calculations as not being posted as adjustments to the test period in this case.

The Commission generally uses the operating ratio methodology in cases where a reasonable rate base cannot be established. The DSC method is used primarily in non-profit water districts where mortgage indentures require specified coverage ratios. On review of the reasonableness of a .88 operating ratio and a 1.2X DSC method, the Commission finds that the 1.2X DSC method yields a rate of return on rate base of 20.75 percent and the .88 operating ratio method yields a rate of return on rate base of 32.36 percent. These are clearly excessive and unreasonable rates of return. Therefore, rehearing on this issue should be denied.

Rates of Return

Elam states that the second finding of the January 13, 1986, Order, which finds the rates of return are reasonable, just and fair, pertains to the authorized tariff rates. Elam contends that the tariff rates are unreasonable, unjust and unfair in that they produced a net deficit of \$9,965 according to "verified" financial statements for the year ended December 31, 1985, as submitted by Elam with its application.

The second finding of the Order of January 13, 1986, pertained to the rates of return granted debt and equity components of long-term capitalization. Additionally, the submission of financial statements for other than the original test period ended March 31, 1985, may be considered as evidence only in a separate rate case with that year as the test period, when they can be subjected to the same evaluation as the test-period financial statements in this case. Therefore, rehearing on this issue should be denied.

FINDINGS AND ORDERS

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

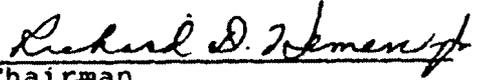
1. The petition for rehearing contained no evidence which was not considered in the Commission's Order of January 13, 1986, or that would merit further consideration.

IT IS THEREFORE ORDERED that:

1. The petition for rehearing is hereby denied.

Done at Frankfort, Kentucky, this 7th day of July, 1986.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary