

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION FOR RATE INCREASE)
OF THE BEAVER-ELKHORN WATER DISTRICT) CASE NO. 9390

O R D E R

On July 31, 1985, Beaver-Elkhorn Water District ("Beaver-Elkhorn") filed an application for authority to increase rates, requesting additional operating revenues of approximately \$50,579 annually, an increase of 14.6 percent over reported test-period operating revenues. Beaver-Elkhorn is a non-profit water utility engaged in the distribution and sale of water to approximately 1,560 customers in Floyd County, Kentucky. A hearing was held on November 14, 1985, in Frankfort.

After the adjustments and determination herein, Beaver-Elkhorn is granted authority to increase rates to produce additional operating revenue of \$14,609, or 4.2 percent.

Staff Audit Report

To simplify the regulatory process for this small utility, the Commission staff performed a limited financial audit for the utility's test period to verify reported expenditures and substantiate the propriety of the test-year financial statements. Although some minor errors were discovered, such as some expenses charged to the wrong accounts, they were not considered material in this proceeding. The staff report was made a part of the

record in this case as an appendix to our Order of October 30, 1985.

ADJUSTMENTS TO EXPENSES FOR RATE-MAKING PURPOSES

Beaver-Elkhorn proposed, and the Commission accepts, the 12-month period ending April 30, 1985, as an appropriate test period for determining the reasonableness of the proposed rates.

The Commission has made, for rate-making purposes, the following modifications to Beaver-Elkhorn's proposed adjustments to test period expenses to reflect more normal and current operating conditions:

Depreciation Expense

Beaver-Elkhorn showed a net loss of \$78,732 for the period, but included in its calculations more than \$60,000 depreciation expense on contributed property. We find it unfair to have customers pay depreciation on assets acquired through these no cost funds. After correction of a minor error, the Commission has adjusted depreciation expense to exclude the \$62,589¹ attributable to utility property which was acquired at no cost, through contribution from customers or federal grant.

Wages and Salaries

Compensation of \$126,088 for the test period has been adjusted to exclude a non-recurring expense of \$5,121 for back

¹ Contributed Plant (Total Contributions/Plant in Service + CWIP x Plant in Service)		\$2,751,097
Composite Depreciation Rate (Test-Year Dep. Exp./Plant in Service)	X	<u>2.27506%</u>
Depreciation on Contributed Property		\$ 62,589

wages paid to an employee during the test period, but to include the full annual cost of a 7 percent wage increase granted after the period but continuing as an expense for the future, for a net increase in this category of \$3,346.² The 7 percent wage increase, which is the first since February, 1983, is considered reasonable.

Other Deductions

On Beaver-Elkhorn's test-period operating statement a loss on sale of land of \$17,998 was included under the heading "Other Deductions." In response to Item No. 13 of the Commission's Information Order of October 25, 1985, Beaver-Elkhorn stated that the item was excluded from its calculation of revenue requirements. Therefore, Beaver-Elkhorn agrees that this item should not be taken into account for rate-making purposes and the amount has accordingly been excluded herein.

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

	<u>Actual Test Period</u>	<u>Commission Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$ 345,654	\$ -0-	\$ 345,654
Operating Expense	375,679	< 59,243>	316,436
Net Operating Income	<u>\$< 30,025></u>	<u>\$ 59,243</u>	<u>\$ 29,218</u>
Other Income	12,243	-0-	12,243
Other Deductions	60,950	< 17,998>	42,952
Net Income	<u>\$< 78,732></u>	<u>\$ 77,241</u>	<u>\$< 1,491></u>

²
 $\$126,088 - \$5,121 = \$120,967$
 $\$120,967 \times 7\% = \$8,467$
 $\$8,467 - \$5,121 = \$3,346$

REVENUE REQUIREMENTS

Debt Service Coverage

Beaver-Elkhorn proposed a debt-service coverage of 1.3X on bond payments averaging \$46,694 per year, and \$17,371 for a 5-year amortization of an overdue note to Kenroy Engineers, Inc., with an unpaid balance of \$86,856 principal and accrued interest remaining. Approval for the execution of this note was not obtained from the Commission as required by KRS 278.300, and this \$17,731 has been excluded from "debt service" for computation of allowable coverage.

Beaver-Elkhorn asserts that a 1.3X coverage would be more appropriate than the 1.2X usually provided for utilities of this size and character, claiming that added coverage was needed because of a depreciation reserve requirement in its bond ordinance. The depreciation reserve provision does not require that any amount be set aside periodically, and it does not specify any particular debt service coverage. It merely requires that any balance of funds in the revenue account be transferred monthly to a depreciation reserve until the fund reaches \$100,000. A cash flow analysis, in which non-cash items such as allowable depreciation plus amortization expense are added back, indicates that with the rates herein allowed, Beaver-Elkhorn should have

approximately \$25,500³ available annually for the bond depreciation reserve or emergencies that may arise. Therefore, the Commission is of the opinion that a 1.2X coverage, which was allowed in Beaver-Elkhorn's last rate case and is generally allowed by the Commission, is appropriate in this case.

Using a debt-service coverage of 1.2X plus operating expenses, the Commission finds Beaver-Elkhorn's total revenue requirement to be \$372,506⁴ and that an increase in annual revenue of \$14,609⁵ from sales of water will be sufficient.

3	Adjusted Net Operating Income	\$29,218
	Add: Revenue Increase Allowed	14,609
	Add: Other Income	12,243
	Add: Non-Cash Expenses:	
	Allowable Depreciation Expense	15,530
	Amortization Expense	648
	Subtotal	<u>\$72,248</u>
	Deduct: Adjusted Other Deductions	
	(Interest on Long-term Debt, 5-year	
	Average, 1986-1990)	<32,325>
	Deduct: 5-year Average Principal Requirement	<u><14,400></u>
	Total Cash Available for Depreciation Reserve	\$25,523
4	Staff-Adjusted Test-Year Operating Expenses	\$316,436
	Add: 5-Year Average Principal and	
	Interest Requirements	46,725
	Add: .2 Coverage of Principal and	
	Interest Requirements	<u>9,345</u>
	Total Revenue Requirement	\$372,506
5	Total Revenue Requirement	\$372,506
	Less: Other Operating Revenues	<7,313>
	Less: Other Income	<12,243>
	Revenue Required from Sales of Water	<u>\$352,950</u>
	Less: Test-Period Revenue from Sales of Water	<u><338,341></u>
	Amount of Increase Allowed	\$ 14,609

The Commission is of the opinion and finds that the revenue granted herein will produce gross annual revenue sufficient to pay Beaver-Elkhorn's operating expenses, service its debt, and provide a reasonable surplus.

RATE DESIGN

The design of the present rate schedule is acceptable, with the exception of the provision for unmetered customers. At the hearing, it was determined that there are no longer any unmetered customers. Therefore, the schedule in Appendix A has eliminated this service class.

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 Beaver-Elkhorn would produce revenue in excess of that found reasonable herein and, therefore, should be denied upon application of KRS 278.030.

2. The rates in Appendix A are the fair, just and reasonable rates for Beaver-Elkhorn in that they are calculated to produce gross annual revenue from water sales of \$352,950. These revenues will be sufficient to meet Beaver-Elkhorn's operating expenses found reasonable for rate-making purposes, service its debt and provide a reasonable surplus.

IT IS THEREFORE ORDERED that:

1. The rates proposed by Beaver-Elkhorn are denied.
2. The rates and charges in Appendix A are approved for service rendered by Beaver-Elkhorn on and after the date of this Order.

3. Within 30 days from the date of this Order, Beaver-Elkhorn shall file with this Commission its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 26th day of February, 1986.

PUBLIC SERVICE COMMISSION

Richard D. Henson, Jr.
Chairman

[Signature]
Vice Chairman

[Signature]
Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 9390 DATED 2/26/86

The following rates and charges are prescribed for the customers in the area served by Beaver-Elkhorn 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.

Rates: Monthly

First 1,000 gallons	\$8.65 Minimum Bill
Next 19,000 gallons	1.55 per 1,000 gallons
Next 30,000 gallons	1.40 per 1,000 gallons
Next 50,000 gallons	1.20 per 1,000 gallons
Over 100,000 gallons	1.05 per 1,000 gallons

Wholesale Rate 1.05 per 1,000 gallons