

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN ADJUSTMENT OF RATES OF THE SANDY)
VALLEY WATER DISTRICT) CASE NO. 9549

O R D E R

On March 31, 1986, Sandy Valley Water District ("Sandy Valley") filed an application requesting authority to adjust its rates pursuant to 807 KAR 5:001. The proposed rates are calculated to produce additional annual revenues of \$93,026, an increase of 35 percent above normalized test period revenues.

A hearing was held on July 17, 1986, at the offices of the Commission in Frankfort, Kentucky. No one intervened. Based on the findings herein, Sandy Valley is allowed to adjust its rates to produce an annual increase of \$41,378, or 15 percent above the level of normalized revenues.

REVENUES AND EXPENSES

Sandy Valley chose a 12-month test period ending September 30, 1985, which the Commission accepts, with financial statements showing a net operating loss of \$47,062. Sandy Valley proposed several adjustments, which have been accepted, with the following exceptions:

Operating Revenues

Sandy Valley reported test year revenues of \$255,224 and normalized revenues of \$270,463 to reflect the increase granted in

its last rate case. Based on actual usage during the test year, the Commission finds normalized revenues to be \$271,117. The Commission has therefore increased normalized revenues by \$654.

However, upon further examination of the records of Sandy Valley, it was determined that approximately 10 percent of billed revenues had been adjusted and thus not reflected in revenue. During the course of the audit, Sandy Valley stated that these adjustments were primarily the result of inaccurate meter readings. Although Sandy Valley has assured the Commission that the adjustments were not the result of water loss on the customer side of the meter, Sandy Valley should implement necessary procedures to alleviate any discrepancies. Based upon this assurance, the Commission has not adjusted revenues to reflect this difference, but emphasizes that such discrepancies cannot be accepted.

Purchased Water Expense

Sandy Valley showed purchased water expense of \$173,507 for the test period. However, \$5,078 was for late payment penalties which have been disallowed for rate-making purposes. With the rates allowed herein, Sandy Valley should not experience the cash flow problems it has in the past. The penalties would therefore be nonrecurring in nature and not a part of normal operations.

Maintenance Expense

Sandy Valley reported \$9,691 for maintenance expense for the test period. By the staff audit report dated July 7, 1986, Sandy Valley was notified that during the audit \$5,541 was found to be for capital items which had been expensed during the test year. Of the \$5,541, Sandy Valley was unable to provide an invoice for

contract labor in the amount of \$1,335 at the time of the audit. Sandy Valley has subsequently provided an invoice for the labor shown as repair work. Sandy Valley also stated in its comments to the audit report filed July 17, 1986, that the invoice to Adams Corporation in the amount of \$420 was for stone used in repair work. The Commission has therefore decreased maintenance expense by \$3,786.

Depreciation Expense

Sandy Valley reported depreciation expense of \$37,015 for the test period, then adjusted this figure to \$15,552 to exclude depreciation expense on contributed property for rate-making purposes.

The Commission, in a previous section of this Order, disallowed \$3,786 as maintenance expense and capitalized these expenditures. Using a 10-year life for the capitalized items, depreciation expense has been increased by the Commission by \$379.

Uncollectible Accounts

Sandy Valley has proposed a 5-year amortization of an uncollectible accumulated debt in the amount of \$29,775 from the Mud Creek Water District ("Mud Creek"). After careful evaluation of the request by Sandy Valley, the Commission considers several factors to be inherent in its denial of the request at this point. The circumstances surrounding the uncollectibility of the Mud Creek account are unclear to the Commission. Upon questioning at the hearing, Sandy Valley provided no witnesses who were able to explain the factors involved with the Mud Creek account. However, it was determined that the account began accumulating probably in

1980 or 1981.¹ Sandy Valley did not request relief with regard to this account in its last rate proceeding, although it apparently was quite delinquent at that time. This has contributed to the cash flow problems Sandy Valley has been experiencing. Although Sandy Valley stated it has mailed notices and had a meeting with the commissioners of Mud Creek, it has taken no other steps to collect this debt. Sandy Valley offered no persuasive reasons for its decision to avoid using legal avenues available for collection. The Commission will not burden the present ratepayers with these costs until the district has exhausted its legal remedies. Should Sandy Valley do so and thus be able to adequately support its request, the Commission may reconsider the request at that time.

The Commission has therefore reduced the proposed uncollectible expense by \$5,955.

Outside Services Expense

Sandy Valley reported test-period outside services expense of \$14,264. The staff audit disclosed that \$3,747 was for rate case expense incurred in its last rate case proceeding. Therefore, outside services expense has been reduced by \$3,747 and placed in the deferred account to be amortized over 3 years as regulatory commission expense.

Regulatory Commission Expense

Sandy Valley reported \$283 for regulatory commission expense for the test period. As mentioned expenses associated with the

¹ Transcript of Evidence ("T.E."), July 17, 1986, page 27.

last rate case are being amortized in this account over 3 years. Therefore, regulatory commission expense has been increased by \$1,249 to normalize the expense for rate-making purposes.

Supplies and Postage Expense

Sandy Valley reported supplies and postage expense of \$6,193. Of that amount, \$949 was for overdrawn bank charges. It is the precedent of the Commission to disallow penalty payments for rate-making purposes. As is the case with the late payment charges for water purchases, the overdrawn charges are denied as part of normal operating expenses; therefore, the Commission has reduced postage and supplies by \$949.

Interest Expense

Sandy Valley proposed a 3-year amortization of interest expense totaling \$6,899, which had never been included in any rate proceeding. The related notes were for approximately \$40,000 and were for operating capital.² The rates set herein have been set to produce revenues which should cover normal operating expenses; therefore, the interest expense should be nonrecurring in nature. To allow the amortization of the nonrecurring interest to be borne by present and future ratepayers would not be fair. The Commission has therefore reduced interest expense by \$2,300.

Amortization of Bond Payment

Sandy Valley has proposed in an amended petition filed July 17, 1986, a 3-year amortization of its January 1986 principal and

2 T.E., page 36.

interest payment of \$22,750 which is now in default.³ To allow the present and future ratepayers to bear the cost of debt payment from a prior period constitutes retroactive rate-making which the Commission does not find reasonable; however, the Commission does not want to place an unfair burden on the district. The Commission believes the rates produced as a result of this proceeding should provide sufficient coverage for operating expenses and current debt coverage. With proper management and the positive cash flow projected at current operating levels, Sandy Valley should be able to adequately cover its defaulted payment within a reasonable time; however, the Commission emphasizes the need for Sandy Valley to adequately monitor its cash flow. The Commission will also monitor Sandy Valley's financial condition through review of its annual reports for the purpose of determining what, if any, future rate adjustments might be necessary. In the event Sandy Valley is unable to meet its obligations or anticipates cash flow problems, it should take appropriate steps at that time to mitigate the effects of such problems; and if necessary, file a rate case.

Therefore, the test-period income statement of Sandy Valley has been adjusted by the Commission as follows:

³ It should be noted that the July 1986 interest payment has been paid.

	<u>Sandy Valley Test-Period Pro Forma</u>	<u>Increase <Decrease> Commission Adjustment</u>	<u>Commission Adjusted</u>
Operating Revenue	\$270,463	\$ 654	\$271,117
Operating Expense	<u>292,278</u>	<u><20,187></u>	<u>272,091</u>
OPERATING INCOME <LOSS>	<u>\$<21,815></u>	<u>\$ 20,841</u>	<u>\$ <974></u>

REVENUE REQUIREMENTS

Sandy Valley proposed the use of the operating ratio rather than the debt service coverage ("DSC") for determination of revenue requirements in this case. Historically, the Commission has used the DSC method for Sandy Valley. Although Sandy Valley has stated it needed the additional funds generated through the use of the operating ratio, it was unable to provide specific information for which the additional monies would be used, such as growth predictions or projected additional expenditures. Sandy Valley's main objection to the use of the DSC was the disallowance by the Commission of depreciation expense on contributed property. Alternatively, the operating ratio also does not allow for depreciation expense on contributed capital. Since a utility should not be allowed recovery of that portion of the plant which has been provided at no cost, the Commission reduces depreciation expense for rate-making purposes for contributions in aid of construction. In this case specifically, no cash flow studies were presented by the utility. The rates the Commission has found reasonable herein should produce revenues sufficient to cover Sandy Valley's obligations under normal operating conditions. The Commission therefore denies the request by Sandy Valley for the

use of an operating ratio at this time which represents a substantial portion of the increase requested herein. However, the bond ordinance for Sandy Valley provides for a parity coverage of 1.25X. Considering the financial status of Sandy Valley, the Commission has used the coverage of 1.25X rather than the historical coverage of 1.2X.

The average annual debt service of Sandy Valley for the next 5 years is \$32,323. The adjusted operating loss of \$974 would produce a negative DSC for Sandy Valley, which is obviously insufficient. To achieve a DSC of 1.25X, which the Commission is of the opinion is the fair, just and reasonable coverage necessary for Sandy Valley to pay its operating expenses and to meet the requirements of its creditors, Sandy Valley would require a net operating income of \$40,404. Accordingly, the Commission has determined that additional revenue of \$41,378 is necessary.

SPECIAL CHARGES

In its amended petition filed on July 17, 1986, Sandy Valley requested permission to implement a 10 percent penalty on late payments. Sandy Valley's current tariff on file has an approved 10 percent late payment charge and is shown on Sandy Valley tariff PSC KY No. 1, Original Sheet No. 4, effective February 13, 1983. Therefore, no further approval by the Commission is necessary. However, it should be noted that the Commission has not made any adjustment to normalize revenues to reflect a late payment charge as it is immaterial in relation to revenues.

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 Sandy Valley would produce revenues in excess of the revenues found reasonable herein and should be denied upon application of KRS 278.030.

2. The rates in Appendix A are the fair, just and reasonable rates to charge for water service rendered to Sandy Valley's customers.

IT IS THEREFORE ORDERED that:

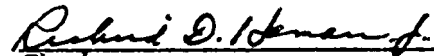
1. The rates proposed by Sandy Valley be and they hereby are denied upon application of KRS 278.030.

2. The rates in Appendix A be and they hereby are approved for water service rendered by Sandy Valley on and after the date of this Order.

3. Within 30 days of the date of this Order, Sandy Valley shall file its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 17th day of September, 1986.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman

ATTEST:

Executive Director


Commissioner

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 9549 DATED SEPTEMBER 17, 1986.

The following rates and charges are prescribed for the customers in the area served by Sandy Valley 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

5/8 - Inch Connection

First	2,000 Gallons	\$6.30 Minimum Bill
Next	3,000 Gallons	2.20 Per 1,000 Gallons
Next	15,000 Gallons	1.90 Per 1,000 Gallons
Next	30,000 Gallons	1.50 Per 1,000 Gallons
Next	50,000 Gallons	1.30 Per 1,000 Gallons
Over	100,000 Gallons	1.15 Per 1,000 Gallons

1 - Inch Connection

First	5,000 Gallons	\$12.90 Minimum Bill
Next	15,000 Gallons	1.90 Per 1,000 Gallons
Next	30,000 Gallons	1.50 Per 1,000 Gallons
Next	50,000 Gallons	1.30 Per 1,000 Gallons
Over	100,000 Gallons	1.15 Per 1,000 Gallons

1 1/2 - Inch Connection

First	10,000 Gallons	\$22.40 Minimum Bill
Next	10,000 Gallons	1.90 Per 1,000 Gallons
Next	30,000 Gallons	1.50 Per 1,000 Gallons
Next	50,000 Gallons	1.30 Per 1,000 Gallons
Over	100,000 Gallons	1.15 Per 1,000 Gallons

2 - Inch Connection

First	25,000 Gallons	\$48.90 Minimum Bill
Next	25,000 Gallons	1.50 Per 1,000 Gallons
Next	50,000 Gallons	1.30 Per 1,000 Gallons
Over	100,000 Gallons	1.15 Per 1,000 Gallons

3 - Inch Connection

First 60,000 Gallons
Next 40,000 Gallons
Over 100,000 Gallons

\$99.40 Minimum Bill
1.30 Per 1,000 Gallons
1.15 Per 1,000 Gallons

4 - Inch Connection

First 100,000 Gallons
Over 100,000 Gallons

\$151.40 Minimum Bill
1.15 Per 1,000 Gallons

6 - Inch Connection

First 300,000 Gallons
Over 300,000 Gallons

\$381.40 Minimum Bill
1.15 Per 1,000 Gallons