

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF CANEY CREEK)
WATER AND SEWER DISTRICT FOR A RATE)
ADJUSTMENT PURSUANT TO THE) CASE NO. 9611
ALTERNATIVE RATE FILING PROCEDURE)
FOR SMALL UTILITIES)

O R D E R

On June 19, 1986, Caney Creek Water and Sewer District ("Caney Creek") filed an application with the Commission to increase its rates pursuant to 807 KAR 5:076, Alternative Rate Adjustment Procedure for Small Utilities ("ARF"). Caney Creek proposed water rates that would produce additional revenue of \$18,197 annually, an increase of 62.60 percent and sewer rates that would produce additional revenue of \$10,863 annually, an increase of 57.07 percent. Based on the determination herein, Caney Creek's water revenues will increase by \$7,793 annually, an increase of 26.81 percent, and sewer revenues will not change.

A hearing was not requested in this matter and, in accordance with the provisions of the ARF, no hearing was conducted. The decision of the Commission is based on information contained in the application, written submissions, the staff audit report, the annual reports and other documents on file in the Commission's offices.

COMMENTARY

Caney Creek is a non-profit water and sewer district organized and existing under the laws of the Commonwealth of Kentucky. Caney Creek provides water service to approximately 106 customers and sanitation service to approximately 96 customers in Knott County, Kentucky.

TEST PERIOD

Caney Creek proposed, and the Commission accepts, the 12-month period ending December 31, 1985, as the test period for determining the reasonableness of the proposed rates.

STAFF AUDIT REPORT

The Commission staff performed a limited financial audit of Caney Creek's test period to verify reported expenditures and substantiate the propriety of the test-year financial statements. During the audit, it was discovered that, for accounting purposes, Caney Creek was treated as a single operating unit and all expenses, with the exception of depreciation expense, were allocated on a ratio of 62 percent to the water division and 38 percent to the sewer division. As a result of a discussion concerning the impropriety of this treatment with Caney Creek's CPA, amended 1985 Annual Reports were filed for both the water and sewer divisions. The workpapers supporting the amended reports were also provided. Based upon the findings in the staff audit report, adjustments were made to test year operations to reflect a net loss of \$13,410 for the water division and of \$3,817 for the sewer division. The staff audit report was made a part of the record in this case on September 2, 1986.

REVENUES AND EXPENSES

Caney Creek proposed numerous adjustments to test year expenses. These adjustments were determined by annualizing the average monthly expenditures for the period from January 1, 1986, through April 30, 1986. In utilizing an adjusted historical test period, the Commission allows for known and measurable increases to expenses. The Commission is of the opinion that the adjustments proposed by Caney Creek are estimations of future expenses, do not meet the known and measurable criteria and are, therefore, improper for rate-making purposes. However, the Commission has made, for rate-making purposes, the following modifications to test period expenses, which are generally considered proper and acceptable, to reflect more normal and current operating conditions:

WATER DIVISION

Fuel or Power Purchased for Pumping

As part of a water and sewer improvements project, Caney Creek installed new pumps and increased the capacity of other pumps at several pumping stations during the test year. The monthly average for the first 5 months of 1986 was 124 percent of the expense incurred during the same period in 1985. As previously stated in this Order, adjustments that are estimations of future expenses are improper for rate-making purposes. However, in this case, since an analysis of the billings for the first 5 months of 1986 indicates that Caney Creek's fuel expenses have increased significantly and due to the fact that a more direct correlation cannot be established, the Commission has determined

that an adjustment to this expense is reasonable. Therefore, the Commission finds that an increase of 24 percent based upon the first 5 months of 1986 is reasonable and has increased power purchased for pumping by \$2,502, from \$10,424 to \$12,926.

Operation Labor

Caney Creek included in the test year \$56 for analysis fees paid by check number 2925 that was actually incurred in December 1984, outside the test period. Therefore, the Commission has reduced the test-period operation labor expense of \$2,478 by \$56 to \$2,422.

Depreciation Expense

Caney Creek's test-year depreciation expense of \$11,272 includes depreciation on contributed property. The Commission finds it unfair to have customers pay for depreciation on assets acquired with contributed funds. Depreciation expense has been adjusted to exclude \$8,284¹ attributable to utility property which was acquired at no cost through contributions from customers or Federal grant.

Interest on Long-Term Debt

Caney Creek allocated \$3,633 or 49 percent of the test-year interest expense on the Farmer's Home Administration ("FmHA") loan

¹ Contributed Plant Composite Depreciation Rate (Test- Year Depreciation Expense/Plant- In-Service)	\$176,324 <u>4.69815%</u>
DEPRECIATION ON CONTRIBUTED PROPERTY	<u>\$ 8,284</u>

to the Water Division. Caney Creek's interest expense has been decreased by \$1,744 to reflect the annual interest expense on the long-term debt outstanding at the end of the test period. As of December 31, 1985, Caney Creek had scheduled outstanding debt of \$114,500. Applying the annual interest rate of 4.125 percent to the outstanding debt results in pro forma interest of \$4,723. Using a 40 percent allocation results in a pro forma interest expense of \$1,889 which is allowed for rate-making purposes. The allocation of 40 percent of the long-term debt and interest expense to the water division and 60 percent to the sewer division was based on the projected plant costs as established in Case No. 4999² and the capitalization as shown in the 1970 Annual Report on file in the Commission's offices.

The Commission has determined that Caney Creek's monthly payments to FmHA are approximately twice the amount required for the test period and suggests that Caney Creek contact FmHA to determine the actual level of monthly payments required.

After consideration of the aforementioned adjustments, the Commission finds Caney Creek's test-period water division operations are as follows:

² Case No. 4999, Application of Caney Creek Water District for Order Authorizing Issue of Bonds, and for a Certificate of Convenience and Necessity, Approval of Financing, and Proposed Water and Sewage Rates, Final Order dated February 26, 1968.

	<u>Test Period Staff Audit</u>	<u>Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$ 29,070	\$ -0-	\$29,070
Operating Expenses	39,077	<5,838>	33,239
Operating Income <Loss>	<u>\$<10,007></u>	<u>\$ 5,838</u>	<u>\$<4,169></u>
Other Income/Deductions (Net)	230	-0-	230
Interest on Long-Term Debt	<u>3,633</u>	<u><1,744></u>	<u>1,889</u>
NET INCOME <LOSS>	<u>\$<13,410></u>	<u>\$ 7,582</u>	<u>\$<5,828></u>

SEWER DIVISION

Fuel and Power Purchased for Pumping and Treatment

As discussed previously in this Order, Caney Creek's purchased power expense has increased due to system modifications. The Commission has increased the sewer division's purchased power expense by \$118 from a test year level of \$493 to \$611.

Depreciation Expense

The Commission has decreased the sewer division's test-year depreciation expense by \$6,249³ to exclude depreciation attributable to contributed property. As stated in the water division's "Depreciation Expense" section of this Order, depreciation expense should be calculated, for rate-making purposes, excluding assets acquired with contributed funds. Therefore, the Commission has reduced the test-year depreciation expense of \$8,503 to \$2,254.

³ Contributed Plant	\$183,521
Composite Depreciation Rate (Test-Year Depreciation Expenses/Plant-in-Service)	<u>3.40510%</u>
DEPRECIATION ON CONTRIBUTED PROPERTY	<u>\$ 6,249</u>

Interest on Long-Term Debt

As with the water division, the Commission has reduced the sewer division's interest expense to reflect the interest on long-term debt outstanding at the end of the test year. Applying the sewer divisions's allocation factor of 60 percent to the pro forma interest of \$4,723 previously calculated results in a reduction of \$950 to the test year expense of \$3,784. Therefore, the interest expense allowed for rate-making purposes is \$2,834.

The effect of these adjustments on the operations of the sewer division are as follows:

	<u>Test Period Staff Audit</u>	<u>Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$ 19,033	\$ -0-	\$19,033
Operating Expenses	19,220	<6,131>	13,089
Operating Income	<u>\$ <187></u>	<u>\$ 6,131</u>	<u>\$ 5,944</u>
Other Income/Deductions (Net)	154	-0-	154
Interest on Long-Term Debt	<u>3,784</u>	<u><950></u>	<u>2,834</u>
NET INCOME <LOSS>	<u>\$ < 3,817 ></u>	<u>\$ 7,081</u>	<u>\$ 3,264</u>

REVENUE REQUIREMENTS

The Commission, in this case, finds the Debt Service Coverage ("DSC") method to be an appropriate method of determining revenue requirements for both the water and sewer divisions and adequate to allow Caney Creek to pay its operating expenses and meet its debt-service requirements. Further, the Commission finds a DSC of 1.2X to be a reasonable level.

The Commission has determined the average principal and interest payments on the FmHA bonds due within the next 5 years to

be \$8,030 and has allocated 40 percent to the water division and 60 percent to the sewer division.

Using a DSC of 1.2X plus the adjusted operating expenses of the water division, the Commission finds the revenue requirement of the water division to be \$37,093⁴ and that an increase in annual water revenue of \$7,793⁵ will be sufficient.

Using a DSC of 1.2X plus the adjusted operating expenses of the sewer division, the Commission finds the revenue requirement of the sewer division to be \$18,871.⁶ However, the adjusted test-

4	Staff Adjusted Test-Year Operating Expenses	\$33,239
	ADD:	
	5-Year Average Principal and Interest Requirements	3,212
	.2 Coverage of Principal and Interest Requirements	<u>642</u>
	TOTAL REVENUE REQUIREMENTS	<u>\$37,093</u>
5	Total Revenue Requirements	\$ 37,093
	LESS:	
	Other Operating Revenues	<528>
	Other Income (Net)	<u><230></u>
	Revenue Required from Sales of Water	\$ 36,335
	LESS:	
	Test Period Revenue from Sales of Water	<u><28,542></u>
	AMOUNT OF INCREASE ALLOWED	<u>\$ 7,793</u>
6	Staff Adjusted Test-Year Operating Expenses	\$13,089
	ADD:	
	5-Year Average Principal and Interest Requirements	4,818
	.2 Coverage of Principal and Interest Requirements	<u>964</u>
	TOTAL REVENUE REQUIREMENT	<u>\$18,871</u>

year operating revenues and other income were \$19,187, indicating a revenue sufficiency of \$316.⁷ The Commission is of the opinion that, in view of the fact that the water and sewer divisions had previously been accounted for as one operating unit with all expenses other than depreciation allocated and that since the amended 1985 Annual Reports as adjusted by the staff audit report do fairly present the operations of each division, the revenue sufficiency of \$316 of the sewer division, being less than 2 percent of the test period revenue from sewer operations, does not warrant a change in the present rates for sewer service.

In determining the revenue requirements for each division, the Commission has considered the water and sewer improvements construction project. The Commission is of the opinion that, after this construction is completed and Caney Creek has a 12-month period that fully reflects the effects of this construction on each division, then Caney Creek should file general rate cases for each division so that the costs of operating the improved systems can be fully reflected in rates.

7	Total Revenue Requirement	\$ 18,871
	LESS:	
	Other Operating Revenues	<285>
	Other Income (Net)	<154>
	Revenue Required from Sewer Operations	\$ 18,432
	LESS:	
	Test Period Revenue from Sewer Operations	<18,748>
	AMOUNT OF DECREASE	\$ <316>

RATE DESIGN

In its application, Caney Creek proposed sewer charges that amount to approximately 60 percent of a customer's water bill. However, due to an increase in the water revenue requirements and the revenue sufficiency in sewer revenues, the rate for sewer service will no longer amount to 60 percent of a customer's water bill. Therefore, Caney Creek's charge for sewer service should be 47 percent of the rate charged its customers for water service. The sewer charge for customers not on the water system should be an amount equal to the minimum water bill under a 3/4-inch size meter.

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 Caney Creek for the water and sewer divisions would produce revenue in excess of that found reasonable herein and, therefore, should be denied upon application of KRS 278.030.

2. Caney Creek's sewer rate should be 47 percent of the rate charged its customers for water service.

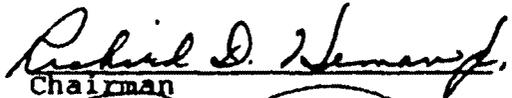
3. The rates in Appendices A and B are the fair, just and reasonable rates for Caney Creek in that they are calculated to produce gross annual revenue from water sales of \$36,339 and from sewer operations of \$18,748. These revenues will be sufficient to meet the water and sewer divisions' operating expenses found reasonable for rate-making purposes and to service the debt.

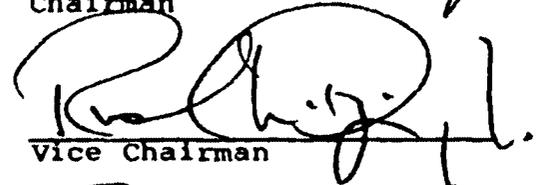
IT IS THEREFORE ORDERED that:

1. The rates proposed by Caney Creek are denied.
2. The rates and charges in Appendices A and B are approved for service rendered by Caney Creek on and after the date of this Order.
3. Caney Creek's sewer rate shall be 47 percent of the rate charged its customers for water service.
4. Within 30 days from the date of this Order, Caney Creek shall file with this Commission its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 6th day of October, 1986.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 9611 DATED 10/06/86

The following water rates and charges are prescribed for all customers in the area served by Caney Creek 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.

WATER RATES

Gallonge Block
For Each Meter Size

Monthly Rate For
Each Gallonge Block

3/4" Meter

First 2,000 Gallons
Next 8,000 Gallons
Over 10,000 Gallons

\$10.25 Minimum Bill
3.25 Per 1,000 Gallons
2.50 Per 1,000 Gallons

2" Meter

First 15,000 Gallons
Over 15,000 Gallons

\$48.75 Minimum Bill
2.50 Per 1,000 Gallons

3" Meter

First 30,000 Gallons
Over 30,000 Gallons

\$86.25 Minimum Bill
2.50 Per 1,000 Gallons

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 9611 DATED 10/06/86

The following sewer rates and charges are prescribed for all customers in the area served by Caney Creek 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.

SEWER RATES

Gallonge Block
For Each Meter Size

Monthly Rate For
Each Gallonge Block

3/4" Meter

First 2,000 Gallons
Next 8,000 Gallons
Over 10,000 Gallons

\$ 4.80 Minimum Bill
1.50 Per 1,000 Gallons
1.20 Per 1,000 Gallons

2" Meter

First 15,000 Gallons
Over 15,000 Gallons

\$22.80 Minimum Bill
1.20 Per 1,000 Gallons

3" Meter

First 30,000 Gallons
Over 30,000 Gallons

\$40.80 Minimum Bill
1.20 Per 1,000 Gallons

Flat Rate

Customers not on the water system are charged a flat rate of \$10.25.