

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF THE BLACK MOUNTAIN )  
UTILITY DISTRICT, OF HARLAN COUNTY, )  
KENTUCKY, FOR APPROVAL OF CONSTRUCTION, ) CASE NO. 9838  
FINANCING, AND NEW RATES )

O R D E R

On January 16, 1987, the Black Mountain Utility District ("Black Mountain") filed its application requesting approval of its proposed construction, financing and rates for both sewer and water services. An Interim Order was issued December 29, 1987, addressing the issues of construction and financing. Therefore, this Order will address the issue of rate increase only.

There were no intervenors and neither the Commission nor Black Mountain sought a hearing in this matter. All requested information has been filed.

COMMENTARY

Black Mountain has provided water service to the Louellen Community since June 1, 1985. However, Black Mountain was operated by the County Judge Executive's office and Black Mountain's financial records were not maintained on a separate basis during the test period. Therefore, the staff was unable to review Black Mountain's financial records to determine a revenue requirement. Thus, the Commission treated Black Mountain as a

newly formed utility and considered both the water and sewer rates as being initial rates.

TEST PERIOD

As stated above, the Commission is treating Black Mountain as a newly formed utility since test period financial records were unavailable for staff's review. Therefore, the Commission relied upon estimated pro forma revenues and expenses to determine Black Mountain's revenue requirement.

SEWER REVENUE AND EXPENSES FROM PROPOSED OPERATIONS

Black Mountain projected operating revenues and expenses from its sewer division of \$25,062 and \$60,823, respectively. The Commission is of the opinion that the projected operating expenses are generally proper and they have, therefore, been accepted. Black Mountain's projected sewer operations are as follows:

	<u>Proposed Sewer Operations</u>
OPERATING REVENUE	\$ <u>25,062</u>
OPERATING EXPENSES:	
Water Expense	\$ 0
Manager Salary	8,775
Electric Power	16,024
Maintenance Expense	10,000
Billing and Collecting	340
Audit and Clerical	5,200
Miscellaneous Expense	3,000
Depreciation Expenses	<u>17,484</u>
TOTAL OPERATING EXPENSE	\$ <u>60,823</u>
NET OPERATING REVENUE	\$ (35,761)
OTHER DEDUCTIONS:	
Interest Expense	<u>0</u>
NET INCOME	<u>\$ (35,761)</u>

## SEWER REVENUE REQUIREMENTS

Black Mountain calculated its revenue requirement on the combined operations of the sewer and water division and then divided the total requirement between the two divisions. Since all water customers do not receive sewer service the Commission is of the opinion that Black Mountain's proposed method of calculating the revenue requirements would cause a cross-subsidization of the sewer service. The Commission is further of the opinion that it would be more correct to treat each of the divisions' revenue requirements as a stand-alone utility, to negate the possibility of cross-subsidization between the sewer and water divisions. This results in a shifting of the revenue burden only and not a measurable change in the overall revenue requirement of the combined operations.

The Commission has used the operating ratio method as the basis for determining sewer rates in the past and has found it to be a fair, just and reasonable method to both the utility and the customer. Black Mountain's proposed sewer operations would provide Black Mountain with an operating ratio of 242.69 percent.<sup>1</sup> The Commission is of the opinion that an operating ratio of 88 percent is fair, just and reasonable in that it will allow Black Mountain ample opportunity to pay its operating expenses and provide for future equity growth. This would require an increase

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<sup>1</sup>  $\$60,823$  (proposed sewer revenue)/ $\$25,062$  (proposed sewer revenue) = 242.69%.

of \$24,187, above the requested amount, calculated in the following manner:

Proposed Operating Expenses Less Depreciation Expense Divided By 88% (\$43,339 ÷ 88%)	\$49,249
LESS: Proposed Operating Revenue	<u>25,062</u>
Required Revenue Increase	<u>\$24,187</u>

Under normal circumstances the Commission would calculate Black Mountain's revenue requirement inclusive of depreciation expense. However, in this instance it was determined that the inclusion would result in excessively high monthly sewer rates and might cause rate-shock. Black Mountain, throughout this proceeding, has expressed its concern with the levels of both its sewer and water rates and agreed with staff<sup>2</sup> that depreciation expense should not be included in the revenue requirement calculation. In eliminating depreciation expense from the determination of the revenue requirement, the Commission is concerned that it might not allow an adequate surplus necessary for equity growth; however, the Commission restates that the financial data is only projections and estimates provided by Black Mountain. Therefore, the Commission grants Black Mountain's sewer division rates which should produce \$49,249, but advises Black Mountain to review its financial position after one year of operations and take the appropriate action it deems necessary.

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<sup>2</sup> Phone conversation between Mark Frost and Jerry Johnson of Black Mountain, on January 18, 1988.

The Commission will also monitor Black Mountain's financial condition through review of Black Mountain's annual reports for the purpose of determining what, if any, future rate adjustments might be required. Further, the Commission is not precluded from determining Black Mountain's future revenue requirement based on the inclusion of depreciation expense.

WATER REVENUE AND EXPENSES FROM PROPOSED OPERATIONS

Black Mountain projected operating revenues and expenses from its water division of \$117,818 and \$58,806, respectively. The Commission is of the opinion that the projected operating expenses are generally proper and they have, therefore, been accepted. Black Mountain's projected water operations are as follows:

	Proposed Water Operations
OPERATING REVENUE	<u>\$ 117,818</u>
OPERATING EXPENSES:	
Water Expense	11,136
Manager Salary	4,725
Electric Power	3,297
Maintenance Expense	5,000
Billing and Collecting	1,115
Audit and Clerical	2,800
Miscellaneous Expense	2,000
Depreciation Expenses	<u>28,733</u>
TOTAL OPERATING EXPENSE	<u>\$ 58,806</u>
NET OPERATING REVENUE	59,012
OTHER DEDUCTIONS:	
Interest Expense	<u>7,500</u>
NET INCOME	<u><u>\$ 51,512</u></u>

WATER REVENUE REQUIREMENTS

Black Mountain's annual debt service based on debt proposed in this proceeding is \$8,525.<sup>3</sup> Black Mountain's requested net operating income of \$59,012 provides a debt service coverage ("DSC") of 6.92X. The Commission, as stated in a previous section, has recalculated Black Mountain's revenue requirement for the water division as a stand-alone entity and is of the opinion that a DSC of 1.2X is fair, just and reasonable in that it will allow Black Mountain ample opportunity to pay its operating expenses, its annual debt payment and provide for future equity growth. A DSC of 1.2X would require a decrease of \$48,782 calculated in the following manner:

1.2X Debt Service (\$8,525 X 1.2)	\$10,230
Add: Proposed Operating Expenses	<u>58,806</u>
Required Revenue	\$69,036
Less: Proposed Operating Revenue	<u>117,818</u>
Decrease Revenue Requirement	<u>\$48,782</u>

The Commission will allow Black Mountain's water division rates which produce \$69,036, rather than the requested amount of \$117,818. The Commission reiterates that the reason for the drastic decrease in water revenues is due to the elimination of cross-subsidization and is only a shifting of the revenue burden from the water division to the sewer division.

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<sup>3</sup> 5-Year Average (Interest Expense)	\$7,425
5-Year Average (Principal Payment)	<u>1,100</u>
5-Year Average Debt Service	<u>\$8,525</u>

### RATE DESIGN

Exhibit K of Black Mountain's application included an initial wastewater rate schedule, a schedule of water rates, and a proposed tap-on fee. In Case No. 9001,<sup>4</sup> the Commission ordered a flat rate for water service; however, in this proceeding Black Mountain has proposed a declining block rate schedule. The Commission concurs with Black Mountain that a declining block rate schedule is more appropriate for water service than a flat rate.

On October 7, 1987, an informal conference was held in Harlan, Kentucky. In response to that conference, Black Mountain filed with the Commission on December 7, 1987, an updated economic report that included a revised waste water and water rate schedule and a billing analysis. On December 15, 1987, Black Mountain filed justification for its proposed tap-on fee.

Based on the information filed, the Commission is of the opinion that the rates and charges proposed by Black Mountain cannot be approved. However, based on the revenue requirement allowed in this case, the rates and charges set out in Appendix A should produce revenues sufficient to cover Black Mountain's operating expenses and should be approved for services rendered.

### OTHER ISSUES

#### Financial Records

Black Mountain will be providing both sewer and water service to its customers. The Commission instructs Black Mountain, in

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<sup>4</sup> The Application of the County of Harlan, Kentucky, for a Certificate of Convenience and Necessity and Approval of Proposed Financing.

order to assure that cross-subsidization between the two divisions does not exist in the future, that financial records be maintained on a separate basis. The Commission also advises Black Mountain that its methodology in allocating common expenses will be reviewed in future proceedings and to carefully evaluate any methodology proposed.

#### FINDINGS AND ORDERS

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

1. The wastewater rates proposed by Black Mountain would produce revenues insufficient to cover its operating expenses and, therefore, should be denied.

2. The water rates proposed by Black Mountain would produce revenues in excess of those found reasonable herein and should be denied.

3. The rates and charges in Appendix A are the fair, just, and reasonable rates and charges to be charged by Black Mountain in that they should produce annual revenues of \$49,249 for sewer service and \$69,036 for water service.

4. Within 30 days of the date of this Order, Black Mountain should file with this Commission tariff sheets setting out its rules and regulations, and the rates approved herein.

5. Black Mountain should file a separate tariff for wastewater and water service.



IT IS THEREFORE ORDERED that:

1. The proposed rates and charges in Black Mountain's revised economic study filed December 7, 1987, be and they hereby are denied.

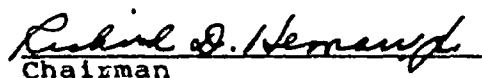
2. The rates and charges in Appendix A are the fair, just and reasonable rates and charges to be charged by Black Mountain for wastewater and water services rendered on and after the date of this Order.

3. Within 30 days of the date of this Order, Black Mountain shall file with this Commission its tariff sheets setting out its rules and regulations and the rates approved herein.

4. Black Mountain shall file a separate tariff for wastewater and water service.

Done at Frankfort, Kentucky, this 29th day of January, 1988.

PUBLIC SERVICE COMMISSION

  
Chairman

  
Vice Chairman

  
Commissioner

ATTEST:

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Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 9838 DATED 1/29/88

The following rates and charges are prescribed for the customers in the area served by Black Mountain Utility 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

<u>Gallonage Block</u>	<u>Rate</u>
First 2,000 gallons	\$11.25 Minimum Bill
Next 2,000 gallons	2.25 per 1,000 gallons
Next 2,000 gallons	2.00 per 1,000 gallons
Next 4,000 gallons	1.85 per 1,000 gallons
Over 10,000 gallons	1.25 per 1,000 gallons

Waste Water

First 2,000 gallons	\$18.25 Minimum Bill
Next 2,000 gallons	3.70 per 1,000 gallons
Next 2,000 gallons	3.45 per 1,000 gallons
Next 4,000 gallons	3.20 per 1,000 gallons
Over 10,000 gallons	2.50 per 1,000 gallons

Tap-On Fee \$150.00