

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF POTTER WATER)
SERVICE FOR A RATE ADJUSTMENT) CASE NO.
PURSUANT TO THE ALTERNATIVE RATE) 92-540
FILING PROCEDURE FOR SMALL UTILITIES)

O R D E R

On December 7, 1992, Potter Water Service ("Potter Water") filed its application for Commission approval to increase its water rates. Commission Staff, having performed a limited financial review of Potter Water's operations, has prepared the attached Staff Report containing Staff's findings and recommendations regarding the proposed rates. All parties should review the report carefully and provide any written comments or requests for a hearing or informal conference no later than 15 days from the date of this Order.

IT IS THEREFORE ORDERED that all parties shall have 15 days from the date of this Order to provide written comments regarding the attached Staff Report or requests for a hearing or informal conference. If no request for a hearing or informal conference is received, then this case will be submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this 19th day of February, 1993.

PUBLIC SERVICE COMMISSION


For the Commission

ATTEST:


Executive Director

COMMONWEALTH OF KENTUCKY
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STAFF REPORT

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STAFF REPORT
ON
POTTER WATER SERVICE
CASE NO. 92-540

A. Preface

On December 7, 1992, Potter Water Service ("Potter Water") filed an application with the Commission seeking to increase its water rates pursuant to the Alternative Rate Filing Procedure for Small Utilities. The proposed rates would generate approximately \$16,040 annually in additional revenues, an increase of 38.2 percent over normalized test-year revenues of \$42,005.

In order to evaluate the requested increase, the Commission Staff ("Staff") chose to perform a limited financial review of Potter Water's operations for the test period, calendar year 1991. Since Potter Water requested and received Staff assistance in preparing this application, the field review was done prior to the filing of the application. Carl Salyer Combs of the Commission's Division of Financial Analysis conducted the review on August 18-19, 1992, at the home of Roy C. Potter, the owner of Potter Water. Mr. Combs is responsible for this Staff Report except for the sections on operating revenues and rate design which were prepared by George Steinmetz of the Commission's Division of Research. Mr. Steinmetz collected the information for his billing analysis December 28, 1992, at the home of Roy C. Potter.

During the course of the review, Potter Water was advised that all proposed adjustments to test-year expenses must be supported by

some form of documentation, such as an invoice, or that all such adjustments must be known and measurable. Based upon the findings of this report, Staff recommends that Potter Water be authorized to increase its annual operating revenues by \$951.

Scope

The scope of the review was limited to obtaining information to determine whether reported test-period operating revenues and expenses were representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

B. Analysis of Operating Revenues and Expenses

Operating Revenues

In its 1991 annual report, Potter Water reported test year operating revenues of \$40,585.

As part of the review of Potter Water, Staff prepared a billing analysis. Based on water usage filed by Potter Water and information obtained during the field review, Staff's billing analysis produced normalized test year revenue of \$42,005.

Operating Expenses

Potter Water reported test-period operating expenses of \$54,282 which it proposed to reduce by \$7,504. After reviewing Potter Water's records, Staff found test-year operating expenses to be reasonable and prudently incurred. The pro forma adjustments and other Staff adjustments to test-period operations are discussed in the following sections:

Salaries and Wages - Officers/Management Fee

Potter Water reported test-year salaries and wages paid to officers of \$9,220. This amount was for Roy C. Potter, the owner and sole officer. Roy Lee Potter, Roy C. Potter's grandson, has assumed the duties associated with the daily operation of the utility, according to Potter Water. Staff is of the opinion that Roy Lee Potter received adequate compensation during the test year for his services as an employee. Since Roy C. Potter is no longer involved in the daily operation of the utility, Staff recommends that the salary of \$9,220 be excluded for rate-making purposes.

As Roy C. Potter is currently providing management services to Potter Water, he is entitled to a management fee. The Commission's normal practice in cases involving small water utilities is to allow an annual management fee of \$2,400 and Staff is of the opinion that that amount is appropriate in this instance. Therefore, Staff recommends inclusion of an annual payment of \$2,400 to Roy C. Potter and further recommends that it be considered a management fee for rate-making purposes.

Materials and Supplies Expense

Potter Water reported test-year materials and supplies expense of \$10,160. However, in its application Potter Water listed a materials and supplies expense of \$2,481. Based upon the field review, Staff agrees that materials and supplies expense of \$2,481 should be included for rate-making purposes.

Miscellaneous Expense

Potter Water reported test-year miscellaneous expense of \$5,999, but listed miscellaneous expense of \$6,174 in its application. According to Potter Water, a test-year payment of \$175 to Paul Baker for tax preparation fees was inadvertently omitted from the total shown in its 1991 annual report. Staff agrees with the inclusion of this payment in miscellaneous expense.

During the test year, Potter Water made payments totaling \$835 to an accounting firm for services related to a previous rate case. Therefore, Staff recommends that test-year miscellaneous expense be reduced by \$835 for rate-making purposes. This matter will be addressed further in this report in a section on amortization expense. Staff has included annual miscellaneous expense of \$5,339 for rate-making purposes.

Depreciation Expense

Potter Water reported test-year depreciation expense of \$13,858. However, of that amount, \$5,245 represents depreciation on non-utility property. Staff recommends that this portion be excluded for rate-making purposes.

In its application, Potter Water proposed to include the cost of a truck purchased in 1991. A copy of the note with Citizens Bank of Pikeville was provided and it shows that the amount financed was \$16,611. As the Commission's Engineering Division has determined that the truck should be depreciated over 5 years, annual depreciation expense associated with that item would be

\$3,322¹ and Staff recommends that amount be included for rate-making purposes. Combined with the reported test-year amount of \$8,613 on utility property, Staff recommends inclusion of total annual depreciation expense of \$11,935 for rate-making purposes.

Amortization Expense

As mentioned previously in the section on miscellaneous expense, Staff recommended that \$835 in accounting fees related to a previous rate case² be excluded for rate-making purposes. Normally, the Commission has allowed expenses related to rate cases to be amortized over 3 years. Therefore, Staff recommends that the aforementioned fees be amortized over 3 years and has included annual amortization expense of \$278 for rate-making purposes.

Interest Expense

Potter Water reported test-year interest expense of \$1,909 which was associated with the purchase of a truck discussed in a previous section on depreciation expense. The truck loan with Citizens Bank of Pikeville is being amortized over 36 months or 3 years. According to the terms of the note, Potter Water should have made 24 payments at this point. Therefore, Staff recommends that interest due for the third year, which totals \$367, be included for rate-making purposes.

¹ \$16,611/5 years = \$3,322 annually.

² Case No. 90-264, The Application of Roy Potter Water Service for a Rate Adjustment Pursuant to the Alternative Rate Filing Procedure for Small Utilities, Order dated March 11, 1991.

Operations Summary

Based on the recommendations of Staff contained in this report, Potter Water's operating statement would appear as follows:

	<u>Test Year Actual</u>	<u>Recommended Adjustments</u>	<u>Test Year Adjusted</u>
Operating Revenues:	\$ 40,585	\$ 1,420	\$42,005
Operating Expense:			
Salaries & Wages-Employees	\$ 10,038	\$ -0-	\$10,038
Salaries & Wages-Officers/ Management Fee	9,220	<6,820>	2,400
Materials & Supplies	10,160	<7,679>	2,481
Contractual Services	561	-0-	561
Transportation Expense	721	-0-	721
Insurance Expense	1,852	-0-	1,852
Miscellaneous Expense	5,999	<660>	5,339
Depreciation Expense	13,858	<1,923>	11,935
Amortization Expense	-0-	278	278
Taxes Other Than Income	1,873	-0-	1,873
Total Operating Exp.	<u>\$ 54,282</u>	<u>\$<16,804></u>	<u>\$37,478</u>
Operating Income	<u>\$<13,697></u>	<u>\$ 18,224</u>	<u>\$ 4,527</u>
Other Deductions:			
Interest Expense	\$ 1,909	\$ <1,542>	\$ 367
Net Income	<u>\$<15,606></u>	<u>\$ 19,766</u>	<u>\$ 4,160</u>

C. Revenue Requirements Determination

The approach frequently used by the Commission to determine revenue requirements for small, privately-owned utilities is the calculation of an operating ratio.³

This approach is used primarily when there is no basis for a rate-of-return determination or due to the fact that the cost of the utility plant has fully, or largely, been recovered through the receipt of contributions, either in the form of grants or donated

³ Operating ratio = operating expense/operating revenue.

property. As Potter Water fits this description, Staff recommends use of an operating ratio for determining revenue requirements. The ratio generally used by the Commission in order to provide for equity growth is 88 percent. In this instance, the use of an 88 percent operating ratio applied to the test-year operating expense plus allowing a dollar-for-dollar coverage of interest expense results in a total revenue requirement of \$42,956 and an increase of \$951⁴ in annual revenues.

D. Rate Design

In Section II, (1)(c) of the application under increased cost information, Potter Water filed a schedule of its present and proposed rates. Potter Water's rate schedule consists of a two step declining block schedule for its retail customers⁵ and a flat rate⁶ for its one resale customer. The proposed rates for the retail customers would increase the first step by approximately 7.9 percent, while increasing the last step by 300 percent. Potter Water's proposed rate for its resale customer is the same as the current rate.

⁴	Adjusted Operating Expense/Operating Ratio	\$ 37,478/.88
	Subtotal	\$ 42,589
	Add: Interest Expense	\$ 367
	Revenue Requirement	<u>\$ 42,956</u>
	Less: Adjusted Test-Year Operating Revenues	<u>\$ <42,005></u>
	Amount of Increase Required	<u>\$ 951</u>

⁵ First 2,000 Minimum Bill
Over 2,000 gallons

⁶ \$.0115 per gallon

Potter Water presented other information in support of this disproportionate distribution of the requested increase. Potter Water explained in its application that sales to Mother Nature Water Plant had declined sufficiently to cause a decrease of \$16,104 in revenue September 1991 and August 1992. This decrease in revenue resulted from a drop in water usage from the test year 1991 to 1992. The residential usage decreased from approximately 4 million gallons to 3.5 million gallons and the wholesale customer's decreased from approximately 2.8 million gallons to approximately 750,000 gallons. The Staff believes that this drop in usage is attributable to the change in rate design approved in March, 1991 and the rate increase approved in August 1991.⁷ Furthermore, at the end of 1992, the usage of the wholesale customer had returned to almost the same level of usage as in the test year.⁸ Potter Water stated a wish to avoid putting any unnecessary hardship on any of their customers by asking for the major part of the increase to be put on the excessive water users.

Until the second quarter of 1991, all of Potter Water's customers paid a flat rate which allowed for an unlimited usage of

⁷ Case No. 91-103, The Application of Roy Potter Water Service for a Rate Adjustment Pursuant to the Alternative Filing Procedure for Small Utilities.

⁸ Mother Nature Water Plant: October 1991 60,200 gallons
October 1992 59,000 gallons, November 1991 60,600 gallons
November 1992, 51,500 gallons.

water. The rate design was changed in Case No. 90-264,⁹ mainly because of a need to promote conservation and increase the customer's awareness of leaks on their property. Potter Water has filed water usage records in this case that indicate that progress in conservation efforts and stopping excessive leakage has taken place since the new rate design has been in effect. The average monthly usage of a retail customer of Potter water has gone from over 6,000 gallons to approximately 5,000 gallons. This precludes relying on the conservation rationale for the disproportional increase to the second step of the rate design as the present rate is already encouraging conservation.

The Commission Staff agrees that the resale customer should be omitted from any rate increase so that in the future it will be encouraged to maintain a usage level that will help pay for the cost of maintaining and upgrading the water system. The Staff believes that an approximate 5.8 percent increase across the board to the retail customers would be the most efficient way to raise the required revenue. Staff has developed rates that will produce the revenue required to meet annual operating expenses and provide for equity growth. Therefore, Staff recommends that the schedule of rates in Appendix A be approved for services rendered.

⁹ Case No. 90-264, The Application of Roy Potter Water Service for a Rate Adjustment Pursuant to the Alternative Filing Procedure for Small Utilities.

E. Signatures

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APPENDIX A
TO STAFF REPORT CASE NO. 92-540

The Staff recommends the following rate be prescribed for customers of Roy Potter Water Service.

Retail Customers

Monthly Rates

First 2,000 gallons
Over 2,000 gallons

\$18.14 Minimum Bill
2.12 per 1,000 gallons

Resale

Mother Nature Water Plant

\$.0115 per gallon