

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF HYDEN-LESLIE COUNTY)
WATER DISTRICT OF LESLIE COUNTY, KENTUCKY)
FOR ORDER OF APPROVING CONSTRUCTION) CASE NO. 93-021
FINANCING, CERTIFICATE OF PUBLIC)
CONVENIENCE AND NECESSITY, AND INCREASED)
RATES)

O R D E R

On February 10, 1993, Hyden-Leslie County Water District ("Hyden-Leslie") filed its application for Commission approval of a proposed increase in its rates for water service. Commission Staff, having performed a limited financial review of Hyden-Leslie's operations, has prepared the attached Staff Report containing Staff's findings and recommendations regarding Hyden-Leslie's 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 8th day of April, 1993.

PUBLIC SERVICE COMMISSION


For the Commission

ATTEST:


Executive Director

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STAFF REPORT

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Public Utility Financial
Analyst, Chief
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Public Utility Rate
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STAFF REPORT

ON

HYDEN-LESLIE COUNTY WATER DISTRICT

CASE NO. 93-021

A. Preface

On January 20, 1993, Hyden-Leslie County Water District ("Hyden-Leslie") submitted an application to the Kentucky Public Service Commission ("Commission") seeking approval of its proposed construction, financing and water rate increase. The application was considered filed on February 10, 1993, when all deficiencies were cured. The proposed rates would generate approximately \$196,842 annually in additional revenues. This represents an increase of 51 percent over normalized test-year revenues from water sales of \$388,965.

In order to evaluate the requested increase, the Commission Staff ("Staff") chose to perform a limited financial review of Hyden-Leslie's operations for the test period, the twelve month period ending November 30, 1992. Karen Harrod, CPA, of the Commission's Division of Financial Analysis conducted the review on February 11, 1993 at the office of Hyden-Leslie in Hyden, Kentucky. Brent Kirtley of the Commission's Division of Rates and Research performed a review of Hyden-Leslie's reported revenues at the offices of the Commission.

On March 18, 1993, the Commission issued an information Order to Hyden-Leslie to obtain additional information to facilitate the review. Hyden-Leslie filed its response to that Order on March 26, 1993.

The findings of Staff's review have been reduced to writing in this report. Mr. Kirtley is responsible for the sections related to operating revenues and rate design. The remaining sections of this

report were prepared by Ms. Harrod. Based upon the findings of this report, Staff recommends that Hyden-Leslie be allowed to increase its annual operating revenues by \$357,870 or 92 percent.

Scope

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

Staff's recommendations made in this report reflect the additional known and measurable expenses to be incurred as a result of the construction and financing proposed in this filing. In its response to the Commission's March 18, 1993 Order, Hyden-Leslie indicated that 408 new customers would be added on to the system as a result of the proposed construction project. Of those new customers, 62 were added on during the test year. Accordingly, adjustments related to new customers are based on additional customers of 346 rather than 408.

During the course of the review, Hyden-Leslie was advised that all proposed adjustments to test year expenses must be supported by some form of documentation and that all such adjustments must be known and measurable.

B. Analysis of Operating Revenues and Expenses

Operating Revenues

Hyden-Leslie reported test-year revenue of \$317,187 in its application submitted to the Commission. Staff's billing analysis supports this revenue amount to within \$740, or a one percent degree of

error, which is the accepted standard for rate-making purposes. As of November 30, 1992, Hyden-Leslie reported 1098 residential customers and 261 commercial customers. Expansion will provide for an additional 333 residential customers at an average usage of 4,780 gallons per month, and an additional 13 commercial customers at an average usage of 12,940 gallons per month. This results in an increase of \$71,038 in annual revenue from sales of water. For the purposes of this report, normalized test-year revenue shall be considered to be \$388,965.

Operating Expenses

For the test year Hyden-Leslie reported operating expenses of \$346,825 which it proposed to increase by \$108,524. In Exhibit 9 of the application, Hyden-Leslie proposed to adjust most of its operating expense accounts based on the estimated increase in the cost of operating the plant upon completion of the proposed construction. According to Hyden-Leslie's engineer, Mr. Kerry Odle, these estimates were calculated based upon the correlating percentage increase in water production, customer number or number of employees, whichever was applicable. With the exception of those expenses discussed below, these adjustments were not sufficiently documented and therefore, did not meet the rate-making criteria of being known and measurable.

Salaries and Wages

In its application Hyden-Leslie proposed to hire 3 additional employees as a result of the construction proposed in this case. Based on the Board Minutes reviewed by Staff, these employees would be needed both during construction and after completion of the project. One

person would be needed to work at the treatment plant while an additional field person would be needed as the new lines are constructed and put into operation. These two employees would be paid at a rate of \$8.00 per hour or annual salaries each of \$16,640. An additional office staff person will be needed upon completion of the project or as new customers are added. This employee would be paid \$5.00 per hour or an annual salary of \$10,400.

Hyden-Leslie currently has 5 employees with a total annual salary expense of \$101,920. During the test year overtime expense of \$5,518 was incurred for additional work performed by the 3 maintenance employees. It is the opinion of Staff that, with the hiring of 3 additional employees, it is not likely that these employees will be required to work the overtime hours required during the test year. Accordingly, overtime wages have not been included in the calculation of pro-forma salary and wage expense.

Based on total salary expense for existing and new employees of \$101,920 and \$43,680, respectively, Staff has calculated pro-forma salary expense to be \$145,600, an increase of \$37,499 over the test-year level. This increase has been included in the calculation of Hyden-Leslie's revenue requirement.

Payroll Tax Expense

For the test year Hyden-Leslie reported payroll tax expense of \$11,017. Staff recommends an adjustment be made to increase payroll tax expense to allow for FICA and Medicare taxes associated with the

recommended increase in salary expense. Accordingly, payroll tax expense has been increased by \$2,869, to a level of \$13,886.

Employee Insurance

Hyden-Leslie reported employee insurance expense of \$30,029 for the test year. Based on the current monthly premium expense of \$2,102.74, the annual expense for existing employees would be \$25,233. The monthly premium per employee is \$474.95. This results in an additional expense for the three new employees of \$17,098 annually.

Based on the aforementioned adjustments Staff recommends a total increase to test-year employee insurance expense of \$12,302.

Rent Expense

During the test period Hyden-Leslie incurred rent expense of \$715 for the rental of a storage building. The district has not leased this building since October of 1992. Therefore, an adjustment has been included to eliminate rent expense from test-year operations for rate-making purposes.

Insurance

For the test year Hyden-Leslie reported property and liability insurance expense of \$6,373. Based on the premium in effect for the fiscal year ended June 30, 1993, this expense is \$7,082. Accordingly, Staff has increased test year insurance expense by \$709, to the current level of \$7,082.

Commissioner Fees

In its test-year operations Hyden-Leslie reported commissioner fees of \$675. During the course of the field review Staff determined that

the test period expense included fees paid for only nine months of the year. Hyden-Leslie has three commissioners who are paid \$25 per month. As a result, Staff recommends that commissioner fees expense of \$900 be included for rate-making purposes.

Chemicals Expense

Hyden-Leslie reported test-year chemicals expense in the amount of \$16,636. After consulting with the Commission's Engineering Division, Staff has concluded that a direct correlation exists between the amount of chemicals used in water production and treatment and the number of customers purchasing that water. Staff has determined that Hyden-Leslie's customer level will increase by 25.46 percent upon completion of the construction. Therefore, an adjustment has been included to increase chemicals expense by that same percentage. This results in a pro-forma chemicals expense of \$20,872.

It should be noted that other expenses such as utilities, maintenance, and repairs, are likely to increase as a result of the increase in customer level. However, there is no known and measurable basis available to Staff for calculating those increases. Therefore, no additional adjustments have been included for rate-making purposes.

Postage Expense

For the test year Hyden-Leslie reported postage expense of \$3,378. It is the opinion of Staff that a direct correlation also exists between postage expense for customer billings and the number of customers. Accordingly, Staff has made an adjustment to increase postage expense by \$860, or 25.46 percent.

Tank Painting

In Exhibit 8 of the application Hyden-Leslie indicated that \$126,500 of the proceeds from the proposed financing would be used for the purpose of painting existing tanks. After consulting with the Commission's Division of Engineering, Staff recommends this expense be amortized over a period of 10 years. Therefore, an adjustment has been made to include tank painting expense of \$12,650 in test-year operations.

Depreciation

Hyden-Leslie reported test period depreciation expense of \$94,309. In its application an adjustment was proposed to include the expense associated with the purchase of a new service truck. Staff has reviewed documentation supporting the need for this vehicle as well as an invoice showing a cost estimate of \$14,446. It is the opinion of Staff that this expense should be depreciated over a period of five years resulting in an annual expense of \$2,889.

An adjustment was not proposed in the application to include depreciation expense on the proposed construction in the calculation of pro-forma operations. However, Staff is of the opinion that it is necessary to include the costs related to the system addition in the determination of pro-forma depreciation expense to ensure that rates will be established at a level which allows Hyden-Leslie to recover the cost of the plant addition. Pursuant to the Commission's Order in Case

No. 10481,¹ dated August 22, 1989, Hyden-Leslie made adjustments to update its revenues and expenses to the level anticipated upon completion of the proposed construction. Since these adjustments reflect the impact that the proposed construction and estimated 346 customers would have on its revenues and expenses, as required by the above referenced case, Staff recommends an increase in depreciation expense of \$78,012.²

As a result of these adjustments, Staff has increased test-year depreciation expense by \$80,901, to a level of \$175,210.

Other Income - Sewer Fees

During the test year Hyden-Leslie reported other income from sewer fees of \$1,800. These fees were collected from Hyden City Sewer for billing services being performed by the district. Staff was advised that Hyden-Leslie is no longer performing this service and, accordingly, has eliminated this income from test-period revenues.

Operations Summary

Based on the recommendations of Staff, Hyden-Leslie's operating statement would appear as set forth in Appendix B to this report.

¹ Notice of Adjustment of the Rates of Kentucky-American Water Company Effective on February 2, 1989.

² Total Project Cost	\$2,466,880
Less: Expense Associated with Painting Existing Tanks	<u>126,500</u>
Depreciable Project Cost	\$2,340,380
Estimated Service Life (Per Commission's Engineering Division)	+ 30 yrs.
Recommended Increase	<u>\$ 78,012</u>

C. Revenue Requirements Determination

Staff has calculated Hyden-Leslie's average annual debt service to be \$216,461. This includes the annual payment for existing debt of \$64,684 and the proposed annual debt payment of \$151,777 related to the post test-period construction. In the event approval for any portion of the construction is not obtained, the recommendations contained herein related to financing and expenses for the construction would change accordingly. Assuming the construction is approved, Staff recommends that the additional debt be included in revenue requirements in order to fund the proposed construction. Based on the adjusted test period operations, Hyden-Leslie's debt service coverage ("DSC") is $-.45x$.³ Staff is of the opinion that a DSC of $1.2x$ is necessary to allow Hyden-Leslie to meet its operating expenses and service its debt. Therefore, Staff recommends that Hyden-Leslie be allowed to increase its annual revenues by \$357,870, calculated as follows:

Adjusted Operating Expenses	\$498,361
Average Annual Debt Service	216,461
20 Percent DSC	43,292
Other Expense	21
Total Revenue Requirement	<u>\$758,135</u>
Less: Normalized Operating Revenues	394,932
Other Income	<u>5,333</u>
Required Revenue Increase	<u>\$357,870</u>

D. Rate Design

The application filed by Hyden-Leslie included a schedule of present and proposed rates that did not include a proposal to change

³ $(\$98,117) \div \$216,461 = (.45)$

this rate structure. Any increase granted in the case has been added to the existing rate structure. The rates set forth in Appendix A will generate revenues from water sales of \$746,835. Therefore, Staff recommends the rates in Appendix A, attached hereto and incorporated herein, be approved for services rendered.

E. Signatures

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Public Utility Financial
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Requirements Branch
Financial Analysis Division

Brent Kirtley J.G.
Prepared By: Brent Kirtley,
Public Utility Rate Analyst,
Communications, Water and
Sewer Rate Design Branch
Rates and Research Division

APPENDIX A
TO STAFF REPORT CASE NO. 93-021

The Staff recommends the following rate be prescribed for customers of Hyden-Leslie County Water District.

Residential Water Rates

First	2,000 gallons	\$17.30	Minimum Bill
Next	3,000 gallons	4.80	per 1,000 gallons
Next	5,000 gallons	3.80	per 1,000 gallons
Next	15,000 gallons	3.10	per 1,000 gallons
Next	25,000 gallons	2.70	per 1,000 gallons
Next	50,000 gallons	2.30	per 1,000 gallons
Next	100,000 gallons	1.90	per 1,000 gallons
Over	200,000 gallons	1.50	per 1,000 gallons

Commercial Water Rates

First	2,000 gallons	\$25.90	Minimum Bill
Next	3,000 gallons	7.20	per 1,000 gallons
Next	5,000 gallons	5.70	per 1,000 gallons
Next	15,000 gallons	4.70	per 1,000 gallons
Next	25,000 gallons	4.10	per 1,000 gallons
Next	50,000 gallons	3.50	per 1,000 gallons
Next	100,000 gallons	2.90	per 1,000 gallons
Over	200,000 gallons	2.30	per 1,000 gallons

APPENDIX B
TO STAFF REPORT CASE NO. 83-021

Hyden-Leslie County Water District
Statement of Adjusted Operations
Test Year Ended 11/30/02

	Test Year Per Ex. 16	Recommended Adjustments	Test Year Adjusted
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Operating Revenues			
Metered Sales	\$317,187	\$71,770	\$388,957
Other Operating Revenues	5,967		5,967
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Total Operating Revenues	\$323,154	\$71,770	\$394,922
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Operating Expenses			
Salaries & Wages	\$109,101	\$37,489	\$146,590
Payroll Taxes	11,017	2,889	13,906
Employee Insurance	30,029	12,302	42,331
Uniform Expense	2,085		2,085
Utilities	35,141		35,141
Chemicals	18,636	4,236	22,872
Repairs & Maintenance	20,661		20,661
Operating Supplies	1,436		1,436
Rent	715	(715)	0
Gas/Diesel	2,556		2,556
Legal & Accounting	5,229		5,229
Water Analysis	3,126		3,126
Postage	3,376	860	4,236
Office Expense	3,856		3,856
Insurance	6,373	709	7,082
Commissioner Fees	875	225	1,100
Miscellaneous	1,503		1,503
Amort. of Tank Painting	0	12,650	12,650
Depreciation	94,309	80,901	175,210
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Total Operating Expenses	\$346,825	\$151,536	\$498,361
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Operating Income	(\$23,671)	(\$79,758)	(\$103,429)
	-----	-----	-----
Other Expense			
Interest	\$21		\$21
	-----	-----	-----
Other Income			
Interest Income	\$5,072		\$5,072
Sewer Fees	1,800	(1,800)	0
Miscellaneous	261		261
	-----	-----	-----
Total Other Income	\$7,133	(\$1,800)	\$5,333
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Inc. Available for Debt Srv.	(\$16,559)	(\$81,558)	(\$98,117)
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