

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF FRANCIS WATER)
COMPANY FOR AN ADJUSTMENT OF)
RATES PURSUANT TO THE ALTERNATIVE) CASE NO. 2004-00338
RATE FILING PROCEDURE FOR SMALL)
UTILITIES)

O R D E R

On September 7, 2004, Francis Water Company ("Francis") filed its application for Commission approval of its proposed water rates. Commission Staff, having performed a limited financial review of Francis'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 10 days from the date of this Order.

IT IS THEREFORE ORDERED that all parties shall have no more than 10 days from the date of this Order to provide written comments regarding the attached Staff Report or requests for hearing or informal conference. If no request for a hearing or informal conference is received, this case will be submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this 19th day of November, 2004.

By the Commission

ATTEST:


Executive Director

STAFF REPORT
ON
FRANCIS WATER COMPANY
CASE NO. 2004-00338

Pursuant to a request by Francis Water Company ("Francis") for assistance with the preparation of a rate application for its water operations, Commission Staff ("Staff") performed a limited financial review of Francis's test year operations for the calendar year ending December 31, 2003. The scope of Staff's review was limited to obtaining information as to whether the test period operating revenues and expenses were representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

Upon completion of the review, Staff assisted Francis in the development and preparation of a rate application. The application included an adjusted pro forma operating income statement wherein adjustments were made to test year operating revenues and expenses that were known and measurable and deemed to be reasonable. The rates proposed by Francis were based on the pro forma income statement as shown in the application. After a review of Francis' current customer make-up, the rates for 1 inch and 1 1/2 inch meters were eliminated as Francis had no current customers using those meter sizes. The application also includes the calculation of Francis's revenue requirement using an operating ratio method, which is frequently used by the Commission to determine revenue requirements for small water utilities with little or no long-term debt. To generate the revenue requirement of \$153,250, Francis is

proposing to increase its annual revenue from water rates by \$94,919, an increase of 163% over normalized revenue of \$58,331.

The 163% increase proposed by Francis is large in percentage terms, but several factors are worth noting. First, Commission records indicate that Francis last increased its general rates in 1989, or more than 15 years ago. Since that time, Francis's costs have increased consistent with cost increases in the overall economy, including the cost of labor, materials, and other expenses.

Second, Francis's avoidance of rate increases over the years has resulted in its customers paying very affordable bills. For an average customer using 5,000 gallons, Francis's current rates would produce an average bill of \$19.00 per month, lower than that of most water utilities regulated by the Commission.

Third, during the Staff's review, Francis indicated that it was facing substantially higher costs because of the need to comply with various regulatory requirements, including those of the Kentucky Division of Water and the Public Service Commission. Most importantly, Francis is being required by the Division of Water to spend more time monitoring the operations of its water treatment plant, and Francis has proposed around-the-clock staffing in order to comply with this requirement. This change alone substantially increases the salaries paid by Francis, from \$15,224 in 2003 to a Staff-recommended level of \$60,300 on a pro-forma basis. In addition, Francis is being required to undertake various capital projects in order to upgrade and maintain its plant, which will result in higher costs related to depreciation, financing, contractual services, and materials and supplies expenses.

Fourth, Francis has proposed to upgrade its security system, to purchase a new billing system, and to buy other equipment and supplies that have not been purchased in recent years. According to Francis, it has underinvested in such systems over the years, and is now proposing to correct that situation. For ratemaking purposes, Staff has proposed to amortize these expenditures over 5 years.

On September 7, 2004, Francis filed its rate application to the Commission for consideration. Staff is hereby adopting the contents of Francis's application as its recommendation in this report as if fully set out herein. Jess Thompson is responsible for all revenue adjustments and the calculation of the proposed rates. Jack Kaninberg is responsible for the determination of the revenue requirement. Based on the information included in Francis's application, Staff is of the opinion that the rates as shown in Attachment A of this report are reasonable and should be approved by this Commission.

Signatures

Prepared by: Jack Kaninberg
Financial Analyst, Water and Sewer
Revenue Requirements Branch
Division of Financial Analysis

Prepared by: Jess Thompson
Rate Analyst, Communications, Water,
and Sewer Rate Design Branch
Division of Financial Analysis

ATTACHMENT A
STAFF REPORT CASE NO. 2004-00338
STAFF'S RECOMMENDED RATES

Monthly Water Rates

5/8"x3/4" Meter:

| | | |
|-------|----------------|------------------------|
| First | 1,000 gallons | \$16.33 Minimum Bill |
| Next | 4,000 gallons | 9.14 per 1,000 gallons |
| Next | 10,000 gallons | 6.65 per 1,000 gallons |
| Over | 15,000 gallons | 5.40 per 1,000 gallons |

2" Meter:

| | | |
|-------|----------------|------------------------|
| First | 60,000 gallons | \$362.39 Minimum Bill |
| Over | 60,000 gallons | 5.40 per 1,000 gallons |

Non-Recurring Charges

| | |
|--------------------------------|----------|
| Meter Connection/Tap-on Charge | |
| 5/8" x 3/4" Meter | \$612.00 |
| Connection/Turn-on Charge | 35.00 |
| Returned Check Charge | 25.00 |

ATTACHMENT B
STAFF REPORT CASE NO. 2004-00338

| Francis WC Recom. Proforma Attachment A | 2003 | Francis's Proposed Adjustmts. | Proposed Adjusted | Staff Recom. Adjustmts. | Ref. | Staff Adjusted |
|---|-----------------|-------------------------------------|----------------------|-------------------------------|------|-------------------|
| Revenues | \$54,697 | \$3,634 | \$58,331 | \$94,919 | (1) | \$153,250 |
| Employee Salaries | \$15,224 | \$138,800 | \$154,024 | (\$93,724) | (2) | \$60,300 |
| Officer Salaries | \$11,024 | 0 | \$11,024 | (\$8,024) | (3) | \$3,000 |
| Employee Benefits | 0 | \$6,500 | \$6,500 | (\$1,700) | (4) | \$4,800 |
| Purchased Power | \$4,540 | 0 | \$4,540 | 0 | | \$4,540 |
| Materials/Supplies | \$5,306 | \$4,720 | \$10,026 | 0 | (5) | \$10,026 |
| Contractual Services | \$515 | \$4,212 | \$4,727 | 0 | (6) | \$4,727 |
| Transportation Exp. | \$2,616 | 0 | \$2,616 | 0 | | \$2,616 |
| Insurance | \$2,657 | \$963 | \$3,620 | 0 | (7) | \$3,620 |
| Misc. Exp | \$3,919 | \$2,374 | \$6,293 | 0 | (8) | \$6,293 |
| Tot. Utility Exp. | \$45,801 | \$157,569 | \$203,370 | (\$103,448) | | \$99,922 |
| Depreciation Exp. | \$1,382 | \$1,642 | \$3,024 | 0 | (9) | \$3,024 |
| Taxes OTI | \$3,849 | \$10,618 | \$14,467 | (\$131) (\$7,784) | (10) | \$6,552 |
| Income Taxes | \$828 | 0 | \$828 | \$2,922 | (11) | \$3,750 |
| Amortization Exp. | 0 | \$10,294 | \$10,294 | (\$4,435) | (12) | \$5,859 |
| Total Op. Expense | \$51,860 | \$180,406 | \$231,983 | (\$112,876) | | \$119,107 |
| Net Income Before Interest Charges | \$2,837 | (\$176,772) | (\$173,652) | \$207,795 | | \$34,143 |

Calculation of Recommended Increase:

\$ 115,357 - Proforma Operating Expenses Before Income Taxes

88% - Operating Ratio

\$ 131,087

\$ 18,413 - Interest payment on \$75,000 loan.

\$ 149,500 - Revenue Requirement Before Tax

(\$133,770) - Proforma Operating and Interest Expenses

\$ 15,730 - After Tax net Income

x 1.23839 Tax Factor

\$ 19,480 - Net Income Before Income Tax (Tax is \$3,750)

\$ 153,250 - Revenue Requirement Including Tax

(\$58,331) - Normalized Revenues

\$ 94,919 - Recommended Revenue Increase

\$153,250/12 = \$12,771/310 = \$41.20 Average Monthly Revenue Per Customer

(\$75,000, 9% for 60 months, repay \$1,556.88 per mo. or \$18,683 per yr., Interest is \$18,412.80 per phone call of 7/9/04.)

Explanatory Notes:

1. Revenues - Recommended increase based upon Staff-adjusted operations.
2. Employee Salaries - Recommended salary levels for ratemaking purposes based upon 2004 survey by Kentucky Rural Water Association.
3. Officer Salaries - Recommended salary for Sterling Francis based upon 2003.
4. **Employee Benefits – Estimated cost of health benefits for employee based upon Anthem Health middle bid of \$400 per month, not including additional coverages.**
5. Materials and Supplies Expense – Per bid estimates dated 8/10/04, estimated cost of various materials needed totals \$4,720, including \$1,140 to replace 30 meters per year; various pipe and other materials inventory of \$1,930 per year; and \$1,650 for annual cost of chlorine (not purchased during 2003) based on purchasing 10 drums per year.
6. Contractual Services Expense – Estimated cost (per bid of 8/4/04) of \$4,212 for additional water testing that must be done annually.
7. Insurance Expense – Estimated cost of flood insurance is \$963 per bid of 8/6/04.
8. **Miscellaneous Expense – Estimated cost of monthly phone service at the water plant is \$874, and estimated annual cost of postage that was not included in the test year is \$1,500.**
9. Depreciation Expense - Recommended expense based upon the needed plant additions:

| Depreciation Exp. | Amount | Life | Expense |
|---------------------------|----------|---------|---------|
| Baptist Bottom Dist. Line | \$17,790 | 50 yrs. | \$356 |
| 2 New Pumps | \$4,000 | 20 yrs. | \$200 |
| New Tank (Blue) Top | \$21,728 | 20 yrs. | \$1,086 |
| Total | \$43,518 | | \$1,642 |

ATTACHMENT B
STAFF REPORT CASE NO. 2004-00338

10. Taxes Other Than Income - Non-FICA Taxes were \$1,841 in 2003, adjusted to remove sales tax remittance of \$131, and allow FICA tax of 7.65% on proposed salaries of \$63,300, or \$4,842.

11. Income Taxes - Federal and State Income Taxes based on a tax factor of 1.23839.

12. Amortization Expense - Recommended Amortization Expense based upon amortizing the following nonrecurring items over 5 years for ratemaking purposes:

| Amortization Exp. | Amount | Period | Expense |
|---------------------|----------|--------|---------|
| New billing system | \$3,595 | 5 | \$719 |
| Security system | \$5,702 | 5 | \$1,140 |
| USA Blue Book Items | \$21,586 | 5 | \$4,317 |
| Total | \$29,297 | 5 | \$5,859 |