

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ALTERNATIVE RATE FILING OF SEDALIA WATER ) CASE NO.  
DISTRICT ) 2009-00107

ORDER

On May 22, 2008, Sedalia Water District ("Sedalia") applied to the Commission for authority to adjust its water rates pursuant to 807 KAR 5:076, the alternative rate filing procedure for small utilities.

Commission Staff, having performed a limited financial review of Sedalia's operations, has prepared the attached report containing its findings and recommendations regarding the proposed rates. All parties should review the report carefully and submit any written comments about Staff's findings and recommendations or requests for a hearing or an informal conference no later than 14 days from the date of this Order.

IT IS THEREFORE ORDERED that:

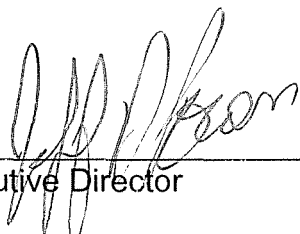
1. All parties shall have 14 days from the date of this Order to submit to the Commission written comments, if any, regarding the attached Staff Report and to request a hearing or an informal conference in this matter.
2. Any party requesting a hearing in this matter shall state in its request its objections to the findings set forth in the Staff Report and provide a brief summary of testimony that it would present at hearing.

3. A party's failure to object to a finding or recommendation contained in the Staff Report within 14 days of this Order shall be deemed as agreement with that finding or recommendation.

4. If no request for a hearing or an informal conference is received within the 14 days, this case shall stand submitted to the Commission for decision.

By the Commission

ATTEST:

  
\_\_\_\_\_  
Executive Director

STAFF REPORT  
ON  
SEDALIA WATER DISTRICT  
CASE NO. 2009-00107

Sedalia Water District ("Sedalia") applied to the Commission for authority to adjust its water rates pursuant to 807 KAR 5:076, the alternative rate filing procedure for small utilities.

In order to evaluate the requested increase Commission Staff performed a limited financial review of Sedalia's test-period operations, the calendar year ending December 31, 2007. 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.

Mark Frost and Sam Reid of the Commission's Division of Financial Analysis performed the limited review. This report summarizes Staff's review and recommendations. Mr. Reid is responsible for the pro forma revenue adjustment and the rate determination. Mr. Frost is responsible for all pro forma expense adjustments and the revenue requirement determination.

The comparison of Sedalia's actual and pro forma operations is attached hereto as Appendix A.<sup>1</sup> Based upon the recommendations and findings of Staff's limited review of the operating revenues and expenses reported in the 2007 Annual

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<sup>1</sup> Application, Attachment A, Proposed Pro Forma.

Report and Sedalia's responses to Staff's Information Request, Sedalia's pro forma operating statement appears as set forth in Appendix B.

The Commission has historically used an operating ratio approach<sup>2</sup> to determine the revenue requirement for a water district when the district has little if any outstanding long-term debt. In that instance, calculating a revenue requirement using the debt service coverage approach would not provide a sufficient level of revenue to cover the water district's operating expenses and/or to provide for equity growth. Because Sedalia does not have an outstanding long-term debt balance, Staff finds that the operating ratio method should be used to determine Sedalia's revenue requirement. Staff further finds that an operating ratio of 88 percent will allow Sedalia sufficient revenues to cover its reasonable operating expenses and to provide for reasonable equity growth.

Using an 88 percent operating ratio, Sedalia determined that its pro forma operations supports a revenue requirement from water sales of \$60,105, which is \$23,131, or 62.6 percent, over reported test period revenues from water sales of \$36,974. According to Sedalia, it is requesting rates that will produce an increase of 25 percent over reported test period revenues or an additional \$9,244 in operating revenues. However, by applying Sedalia's requested rates to its billing analysis, Staff determined that Sedalia is actually requesting a revenue requirement from rates of \$42,366, an increase of \$8,486 over Staff's normalized revenues of \$33,880.

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<sup>2</sup> Operating Ratio is defined as the ratio of expenses, including depreciation and taxes, to gross revenues.

$$\text{Operating Ratio} = \frac{\text{Operating Expenses} + \text{Depreciation} + \text{Taxes}}{\text{Gross Revenues}}$$

As shown in Table 1 below, Staff's recommended pro forma operations and an operating ratio of 88 percent results in a revenue requirement from rates of \$51,980, an increase of \$18,100, or 53.4 percent, over Staff's normalized revenue from rates of \$33,880.

Operating Expenses	\$	45,743
Divided by: Operating Ratio	÷	88%
Revenue Requirement - Water Rates	\$	51,980
Less: Normalized Operating Revenue	-	33,880
Increase in Revenue from Rates	\$	18,100

Staff finds that Sedalia's requested revenue requirement will produce a positive cash flow of \$10,454,<sup>3</sup> is sufficient for it to pay the pro forma "cash" expenses, and will provide for future equity growth. Therefore, Staff recommends the Commission allow Sedalia to increase its water rates to a level that will generate the requested revenue requirement of \$42,366. Should Sedalia decide to further increase rates to generate the \$51,980 revenue requirement as determined by Staff, it should amend its application to request that level of revenue and shall provide confirmation to the Commission that it has published notice of those rates pursuant to 807 KAR 5:011, Section 8.

Staff recommends that the Commission approve the rates that were requested by Sedalia as set forth in Appendix C. If Sedalia amends its application, then it

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<sup>3</sup> Requested Increase	\$	8,486
Add: Normalized Operating Revenues	+	33,880
Total Requested Revenue	\$	42,366
Less: Pro Forma Operating Expenses	-	45,743
Net Operating Income	\$	(3,377)
Add: Depreciation & Amortization	+	13,831
Net Cash Flow	\$	10,454

should amend its application to reflect the rates contained in Appendix D, as they will produce the revenue requirement of \$51,980 Staff determined Sedalia could justify.

Signatures



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Prepared by: Mark C. Frost  
Financial Analyst, Water and Sewer  
Revenue Requirements Branch  
Division of Financial Analysis



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Prepared by: Sam Reid  
Manager, Communications, Water and  
Sewer Rate Design Branch  
Division of Financial Analysis

APPENDIX A  
 STAFF REPORT, CASE NO. 2009-00107  
 SEDALIA'S REQUESTED  
 PRO FORMA INCOME STATEMENT

	<u>Test-Period Operations</u>	<u>Pro Forma Adjustments</u>	<u>Pro Forma Operations</u>
Operating Revenues:			
Metered Water Sales	\$ 36,974	\$ 0	\$ 36,974
Operating Expenses:			
Operation & Maintenance:			
Purchased Power	\$ 6,374	\$ (3,266)	\$ 3,108
Chemicals	6,297	(2,303)	3,994
Materials & Supplies	8,870	(5,229)	3,641
Contractual Services	21,898	(6,575)	15,323
Water Testing	1,664	0	1,664
Insurance	2,781	0	2,781
Miscellaneous	3,961	0	3,961
Total Operation & Maint. Exp.	\$ 51,845	\$ (17,373)	\$ 34,472
Depreciation	17,016	814	17,830
Amortization	0	525	525
Taxes Other Than Income:	65	0	65
Utility Operating Expenses	\$ 68,926	\$ (16,034)	\$ 52,892
Net Utility Operating Income	<u>\$ (31,952)</u>	<u>\$ 16,034</u>	<u>\$ (15,918)</u>

APPENDIX B  
 STAFF REPORT, CASE NO. 2009-00107  
 STAFF'S RECOMMENDED  
 PRO FORMA INCOME STATEMENT

	<u>Test-Period Operations</u>	<u>Pro Forma Adjustments</u>	Adj. Ref	<u>Pro Forma Operations</u>
Operating Revenues:				
Metered Water Sales	\$ 36,974	\$ (3,094)	(a)	\$ 33,880
Operating Expenses:				
Operation & Maintenance:				
Purchased Power	\$ 6,374	\$ (2,882)	(b)	\$ 3,492
Chemicals	6,297	(2,847)	(c)	3,450
Materials & Supplies	8,870	(6,766)	(d)	2,104
Contractual Services	21,898	(8,017)	(e)	13,881
Water Testing	1,664	0		1,664
Insurance	2,781	(11)	(f)	2,770
Miscellaneous	3,961	0		3,961
Total Operation & Maint. Exp.	\$ 51,845	\$ (20,523)		\$ 31,322
Depreciation	17,016	(3,185)	(g)	13,831
Amortization	0	525	(h)	525
Taxes Other Than Income:	65	0		65
Utility Operating Expenses	\$ 68,926	\$ (23,183)		\$ 45,743
Net Utility Operating Income	<u>\$ (31,952)</u>	<u>\$ 20,089</u>		<u>\$ (11,863)</u>



Pro Forma Adjustment Descriptions.

a. Metered Water Sales. In its 2007 Annual Report, Sedalia reported test-period revenue from metered water sales of \$36,974. Applying the current tariffed rates to the billing information supplied by Sedalia, Staff prepared the billing analysis shown in Table 2 below.

Table 2: Staff's Billing Analysis					
	<u>Gallons</u>	<u>Bills</u>	<u>Sales</u> <u>Gallons</u>	<u>Tariffed</u> <u>Rates</u>	<u>Revenue</u>
First	2,000	1,697	2,809,158	\$ 12.14	\$ 20,601.58
Next	8,000		3,504,376	\$ 3.12	10,933.65
All Over	10,000		1,023,917	\$ 2.29	2,344.77
Totals			7,337,451		\$ 33,880.00

Staff is proposing to reduce test-period revenues from water sales of \$36,974 by \$3,094 to reflect the results of its billing analysis.

b. Purchased Power and Chemicals. In its 2007 Annual Report, Sedalia reported an unaccounted-for water loss of 8,583,000 gallons, or 53.387 percent. Sedalia attributes its excessive line loss to the refurbishing and cleaning of its 100,000 gallon elevated water tower.<sup>1</sup> During the refurbishing of its water tower, Sedalia claims that it was forced to continuously run its pumps, which caused elevated system pressure during periods of low customer demand.<sup>2</sup> To ensure that the elevated system pressure would not cause its water mains to rupture, Sedalia set the relief valves to flush water out onto the ground when the water pressure in the lines reached 50 pounds.<sup>3</sup> Sedalia is proposing to reduce purchased power expense by \$3,266 and

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<sup>1</sup> Sedalia's response to Commission Staff's First Information Request, item 5.

<sup>2</sup> Id.

<sup>3</sup> Id.

chemical expense by \$2,303 to reflect the normal operating conditions experienced in 2006.<sup>1</sup>

Sedalia's test-period line loss of 53.387 percent exceeds the Commission's allowable limit of 15 percent.<sup>2</sup> In 2007, Sedalia's variable costs of water production were chemicals of \$6,297 and electricity of \$6,374. Staff is proposing to limit Sedalia's test-period line loss to 15 percent, which results in a decrease to chemical expense of \$2,847 and a decrease to electricity expense of \$2,882, as calculated in Table 3 below.

	<u>Chemicals</u>	<u>Purchased Power</u>
Test-Period Expenses	\$ 6,297	\$ 6,374
Divided by: Total Water Purchases	÷ 16,077,000	÷ 16,077,000
Costs per 1 Gal.	<u>\$ 0.00039168</u>	<u>\$ 0.00039647</u>
Pro Forma Water Sales - Gallons	7,487,451	7,487,451
Divided by: Line Loss Reciprocal	÷ 85%	÷ 85%
Allowable Water Purchases	8,808,767	8,808,767
Multiplied by: Costs per 1 Gal.	x 0.00039168	x 0.00039647
Pro Forma Expense Level	\$ 3,450	\$ 3,492
Less: Actual Test-Period Expense	- 6,297	- 6,374
Pro Forma Adjustment	<u>\$ (2,847)</u>	<u>\$ (2,882)</u>

c. Materials and Supplies. Sedalia proposes to reduce its test-period materials and supplies expense of \$8,870 by \$5,230 to remove several capital expenditures that were incorrectly recorded as operating expenses in the test period. In reviewing the test-period invoices, Staff discovered an additional \$1,536 of capital expenditures that were incorrectly expensed. To eliminate the capital expenditures that are listed in Table 4 below, Staff is proposing to reduce Sedalia's materials and supplies expense by \$6,766.

<sup>1</sup> Id. Sedalia's unaccounted-for line loss was 4.5261 percent in 2006.

<sup>2</sup> 807 KAR 5:066, Section 6(3), limits line loss for rate purposes.

<u>Date</u>	<u>Vendor</u>	<u>Description</u>	<u>Amount</u>
07/01/07	G&C Supply	Hydrant and Related	\$ 2,383
09/27/07	CSS	12 Meters	\$ 441
10/15/07	CSS	Meters & Couplings	\$ 919
11/27/07	CSS	2" Meters, etc.	\$ 1,487
02/17/07	G&C Supply	Pipe for Inventory	\$ 364
02/17/07	USA Bluebook	10 Meters	\$ 324
06/11/07	G&C Supply	Set Hydrant	\$ 425
07/30/07	GSS	Parts for Meter Service	\$ 423

d. Contractual Services. Sedalia proposes to reduce its test-period contractual service expense of \$21,898 by \$6,575 to remove a nonrecurring payment of \$1,875 made to Sedalia's contract operator and to eliminate \$4,700 of capital expenditures that were incorrectly recorded as operating expenses in the test period.

According to the 2008 General Ledger, the test-period meter reading and billing expense was \$12,390. Sedalia currently has two contract employees, an operator and an employee for meter reading/customer billing. Sedalia is currently paying its contract employees a combined fee of \$800 per month. By multiplying the monthly contract labor fee of \$800 by 12 annual payments, Staff calculates a normalized expense level of \$9,600, which is \$2,790 below the amount reported. Accordingly, Staff recommends that contract service expense be decreased by \$2,790.

In reviewing the test-period invoices, Staff discovered \$5,227 of capital expenditures that were incorrectly expensed. To eliminate the capital expenditures that are listed in Table 5 below, Staff is proposing to reduce Sedalia's contractual services expense by an additional \$5,227 for a total reduction of \$8,017.

<u>Date</u>	<u>Vendor</u>	<u>Description</u>	<u>Amount</u>
04/27/07	J&L Plumbing	Locate Main	\$ 665
06/27/07	J&L Plumbing	Valve Inspections	\$ 825
07/01/07	Dale Burnett	Install Tap Sleeve & Valve	\$ 618

09/27/07	J&L Plumbing	Repair Leaks	\$ 1,225
10/15/07	J&L Plumbing	Install 2 Meters	\$ 637
11/27/07	J&L Plumbing	Rework Water Lines	\$ 730
07/05/07	Darwin Noffsinger	Line Extension - Subdivision	\$ 527

e. Insurance. Sedalia reports a test-period level of insurance expense of \$2,781. The insurance premiums for the 12-month period of July 1, 2009 through July 1, 2010 are \$2,770, which is \$11 less than the reported expense. Accordingly, Staff is proposing to reduce test-period insurance expense by \$11.

f. Depreciation. Sedalia proposes to increase its test-period depreciation expense of \$17,016 by \$814 to reflect depreciating the capital expenditures removed from operating expenses over their estimated useful lives. As shown in Table 6 below, Staff calculates a pro forma depreciation adjustment of \$884 to reflect depreciating the capital expenditures removed from operating expenses over their estimated useful lives.

<u>Date</u>	<u>Description</u>	<u>Amount</u>	<u>Depreciation</u>	
			<u>Life</u>	<u>Expense</u>
07/01/07	Hydrant and Related	\$ 2,383	40	\$ 60
09/27/07	12 Meters	441	10	44
10/15/07	Meters & Couplings	919	10	92
11/27/07	2" Meters, etc.	1,487	10	149
02/17/07	10 Meters	324	10	32
06/11/07	Set Hydrant	425	40	11
07/30/07	Parts for Meter Service	423	40	11
04/27/07	Locate Main	665	10	67
06/27/07	Valve Inspections	825	10	83
07/01/07	Install Tap Sleeve & Valve	618	10	62
09/27/07	Repair Leaks	1,225	10	123
10/15/07	Install 2 Meters	637	10	64
11/27/07	Rework Water Lines	730	10	73
07/05/07	Line Extension - Subdivision	527	40	13
<b>Totals</b>		<b>\$ 11,629</b>		<b>\$ 884</b>

As previously noted, Sedalia refurbished and painted its 100,000 elevated water tower in 2007. Sedalia depreciated the cost of the water tower project of \$94,957 over a seven-year life, for an annual depreciation expense of \$13,565. After consulting with the Commission's Engineering Division, Staff has determined that a more appropriate useful life for the water tower project is 10 years. Depreciating the water tower project over 10 years results in an annual depreciation expense of \$9,495, which is \$4,069 less than the test-period level reported by Sedalia. Accordingly, Staff is proposing to reduce depreciation by \$4,069, for a net depreciation expense adjustment of \$3,185.

g. Amortization. Sedalia proposes to increase operating expenses by \$525 to reflect amortizing the cost of preparing this current application over three years. Upon review of the supporting invoice, Staff believes that the cost to prepare Sedalia's application is reasonable and should be reflected in pro forma operations. Accordingly, Staff is proposing to accept Sedalia's adjustment to increase operating expense by \$525.

APPENDIX C  
STAFF REPORT, CASE NO. 2009-00107  
REQUESTED RATES AND CHARGES

**RATES AND CHARGES**

<u>RATE CLASSIFICATION</u>			<u>Rates</u>	
First	2,000	Gallons	\$	15.18 Minimum Bill
Next	8,000	Gallons	\$	3.90 per 1,000 Gallons
Over	10,000	Gallons	\$	2.87 per 1,000 Gallons

APPENDIX D  
STAFF REPORT, CASE NO. 2009-00107  
RATES AND CHARGES  
SEDALIA COULD JUSTIFY

**RATES AND CHARGES**

<u>RATE CLASSIFICATION</u>			<u>Rates</u>	
First	2,000	Gallons	\$ 18.63	Minimum Bill
Next	8,000	Gallons	\$ 4.79	per 1,000 Gallons
Over	10,000	Gallons	\$ 3.50	per 1,000 Gallons

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