

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF OLDHAM WOODS)	
SANITATION, INC. FOR RATE ADJUSTMENT)	CASE NO.
FOR SMALL UTILITIES PURSUANT TO 807 KAR)	2016-00131
5:076)	

ORDER

On March 28, 2016, Oldham Woods Sanitation, Inc. ("Oldham Woods") tendered an application to the Commission for an adjustment of sewer rates pursuant to 807 KAR 5:076. However, the application was not considered filed until April 11, 2016, the date the deficiencies in the application were cured.

Commission Staff performed a limited financial review of Oldham Woods' operations, and on July 7, 2016, released its initial report containing Staff's findings. On July 26, 2016, Oldham Woods filed its response to Commission Staff's report requesting reconsideration of several of the Commission Staff findings and inclusion of the cost of operational changes occurring subsequent to the issuance of the Staff Report. An informal conference was scheduled and held on August 17, 2016, at the Commission's offices in Frankfort, Kentucky, to discuss Oldham Woods' responses. At the conference Oldham Woods agreed to file supplemental information, which it filed on August 25, 2016. The report attached hereto contains amendments to Staff's original findings, which are based upon the issues raised at the August 17, 2016 informal conference and the supplemental information filed by Oldham Woods.

Finding that Oldham Woods should be afforded the opportunity to respond to Commission Staff's amendments to its original findings, the Commission HEREBY ORDERS that:

1. Oldham Woods shall have 14 days from the date of this Order to file with the Commission written comments, if any, on the findings and recommendations contained in the attached Amended Staff Report and to request a hearing with the Commission in this matter.

2. Oldham Woods' failure to file with the Commission written objections to a finding contained in the Amended Staff Report within 14 days of this Order shall be deemed as agreement with that finding and a waiver of any right to object to that finding.

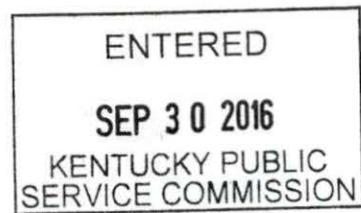
3. If Oldham Woods requests a hearing in this matter, it shall specifically identify in its written request for hearing all objections to the findings and recommendations set forth in the Amended Staff Report and shall provide a brief summary of testimony that it expects to present at hearing.

4. Within 14 days of the date of this Order, Oldham Woods shall file with the Commission in writing its position on adjusting its rates to the level shown in Appendix B of the Amended Staff Report.

5. If Oldham Woods wishes to amend its application to request the rates shown in Appendix B of the Amended Staff Report, it shall request such amendment in its response and shall mail notice of its amended rate request pursuant to 807 KAR 5:011, Section 8, and shall provide the Commission with proof of such notice.

6. If the Commission does not receive any written request for a hearing within the 14 days of the date of this Order, this case shall stand submitted to the Commission for decision based upon the existing record.

By the Commission



ATTEST:


Executive Director

Case No. 2016-00131

AMENDED
STAFF REPORT
ON
OLDHAM WOODS SANITATION, INC.
CASE NO. 2016-00131

On March 28, 2016, Oldham Woods Sanitation, Inc. (“Oldham Woods”) tendered an application to the Commission for an adjustment of sewer rates pursuant to 807 KAR 5:076. After Oldham Woods corrected filing deficiencies, its application was accepted for filing on April 11, 2016. Using an 88 percent operating ratio,¹ Oldham Woods determined that a revenue increase of \$12,211, or 22.39 percent, was warranted.² Oldham Woods requested to increase its flat monthly wastewater service rate from \$36.07 to \$44.15, an increase of \$8.08, or 22.4 percent.

In order to evaluate the reasonableness of Oldham Woods’ pro forma financial statements, revenue requirement calculation, and requested sewer rates, Commission Staff performed a limited financial review of Oldham Woods’ test-year operations for the calendar year 2015. On July 7, 2016, Commission Staff issued a report finding that

¹ An operating ratio measures the difference between operating revenues and operating expenses. It is defined by the following equation.

$$\text{Operating Ratio} = \frac{\text{Operation \& Maintenance Exp. + Depreciation + Taxes}}{\text{Gross Revenues}}$$

The Commission has found that the operating ratio is a reasonable and necessary alternative to the rate of return method for calculating the allowable Net Operating Income for small sewer investor-owned utilities. Specifically, it has found that the rate-of-return method cannot be used because there is “no basis” upon which to determine a rate of return for these utilities, Administrative Case No. 95-236, *Application of Thelma Waste Control, Inc. for a Rate Adjustment Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC. Apr. 15, 1996) at 6. Further, it has found that the operating-ratio method is appropriate when plant investment is low and operating expenses are high, Case No. 7982, *Notice of Application of Fern Lake Company* (Ky. PSC. Aug. 27, 1981) at 3.

² Application at 15.

Oldham Woods' adjusted test-year operations would support a revenue requirement of \$61,407, which would require a revenue increase of \$6,869.³ Commission Staff determined that for Oldham Woods to achieve this level of revenue, it would require a monthly flat sewer rate of \$40.61,⁴ an increase of \$4.54, or 12.59 percent, to its current rate of \$36.07.

On July 26, 2016, Oldham Woods filed its response to Commission Staff's report requesting reconsideration of several of the report findings and inclusion of the cost of operational changes occurring subsequent to the issuance of the Staff Report. An informal conference was scheduled and held on August 17, 2016, at the Commission's offices in Frankfort, Kentucky, to discuss Oldham Woods' responses. At the conference Oldham Woods agreed to file supplemental information, which it filed on August 25, 2016. Based upon the issues raised at the informal conference and the supplemental information filed by Oldham Woods on August 25, 2016, Commission Staff is amending its original findings.

Summary of Findings

Using its revised pro forma operations, Commission Staff calculates an overall revenue requirement for Oldham Woods of \$71,469, which requires a revenue increase of \$16,931. Oldham Woods' requested revenue requirement produces a cash working capital of \$12,944⁵ and is sufficient to meet pro forma "cash" expenses. Therefore, Oldham Woods should be granted its requested revenue requirement of \$66,749.

³ Staff Report at 10.

⁴ \$61,407 (Commission Staff Revenue Requirement) ÷ 12 (Months) ÷ 126 (No. of Customers) = \$40.61.

⁵ \$66,479 (Requested Revenue Requirement) - \$62,893 (Commission Staff's Revised Operating Expenses) + \$9,358 (Commission Staff Revised Depreciation and Amortization) = \$12,944.

However, if Oldham Woods wishes to request Commission Staff's revised revenue requirement of \$71,469, it should do so in its written response to this report.

Commission Staff recommends that the Commission approve the rate Oldham Woods requested and that is set forth in Appendix A. The rate contained in Appendix B will produce Staff's revised revenue requirement of \$71,469.

Amended Pro Forma Operating Statement

The Amended Pro Forma Operating Statement for the test year ended December 31, 2015, as determined by Commission Staff, appears below.

	Pro Forma Operations Staff Report	Revised Adjustments	Adj. Ref.	Revised Pro Forma Operations
Operating Revenues				
Sewer Sales Revenue	\$ 54,538			\$ 54,538
Operating Expenses:				
Operation and Maintenance Expenses:				
Owner/Manager Fee	3,600			3,600
Collection System	25,489	7,473	(A)	32,962
Purchased Power	8,622			8,622
Chemicals	1,766			1,766
Agency Collection Fee	3,931			3,931
Miscellaneous General Expenses	1,339			1,339
Total Operation and Maintenance Exp.	44,747	7,473		52,220
Depreciation	6,425	952	(B)	7,377
Amortization	1,551	430	(C)	1,981
Taxes Other Than Income Tax	1,315			1,315
Total Operating Expenses	54,038	8,855		62,893
Net Operating Income	\$ 500	\$ (8,855)		\$ (8,355)

(A) Routine Maintenance Fee. Camden Environmental Services ("Camden") is the certified operator that handled the day-to-day operations of Oldham Woods' wastewater treatment system. In April 2015, Camden increased the routine

maintenance fee it charged from \$350 to \$495 per month, resulting in an annual expense increase of \$5,940.⁶ Oldham Woods proposed to increase its routine maintenance fee expense by \$435⁷ to reflect the current annual cost, which Commission Staff found reasonable.

In its responses to the Staff Report, Oldham Woods explained that a change in the Kentucky Administrative Regulations (“KAR”) now requires daily inspections of wastewater plant equipment. Oldham Woods states that for Camden to perform the daily plant inspections, the routine maintenance fee will increase by \$540 per month. At the informal conference Oldham Woods informed Commission Staff that in 2016 it began to perform annual inspections of its manholes to comply with KAR requirements. To show how these operational changes will affect its pro forma operating expenses, Oldham Woods submitted in its August 25, 2016 filing copies of the new routine maintenance contract and of the 2016 manhole inspection invoice.

807 KAR 5:071, Section 7 (4) requires that:

Unless otherwise authorized in writing by the Commission, the sewage utility shall make inspections of collecting sewers and manholes on a scheduled basis at intervals not to exceed one (1) year, unless conditions warrant more frequent inspections and shall make inspections of all mechanical equipment on a daily basis.

To ensure that Oldham Woods’ treatment plant continues to operate and conform to all of the regulatory requirements, Commission Staff finds that the pro forma routine

⁶ \$495 (Increased Monthly Fee) x 12 (Months) = \$5,940.

⁷ \$5,940 (Current Annual Routine Maintenance Fee) - \$5,505 (Test Year Routine Maintenance Fee) = \$435.

maintenance fee expense should be adjusted to reflect the cost for Oldham Woods to comply with 807 KAR 5:071, Section 7(4).

The new Camden contract covers the 12-month period from November 1, 2016, through October 31, 2017, and requires a \$1,035 monthly fee, resulting in an annual cost of \$12,420.⁸ Combining this cost with the \$993 cost to inspect the manholes results in a revised pro forma expense of \$13,413.⁹ Accordingly, Commission Staff is increasing its original pro forma routine maintenance fee expense of \$5,940 by \$7,473.¹⁰

(B) Depreciation. Oldham Woods reported \$7,951 for test-year depreciation expense, which included \$2,175 of depreciation expense for the repairs made to its gravel access road. In calendar years 2012 and 2014, Oldham Woods spent a total of \$14,775 repairing its gravel access road.¹¹ Oldham Woods depreciated the cost of the gravel road repairs incurred in 2012 over five years and the 2014 repair cost over ten years.

Upon its review of the National Association of Regulatory Utility Commissioners Study of Depreciation Practices for Small Water Utilities (“NARUC Study”) dated August 15, 1979, Commission Staff determined that the gravel access road would be classified in the category of structures and improvements, which has a depreciation life range of 35 years to 40 years. Commission Staff depreciated the gravel access road over 35

⁸ \$1,035 (Increased Monthly Fee) x 12 (Months) = \$12,420.

⁹ \$12,420 (Revised Camden Contract) + \$993 (Manhole Inspections) = \$13,413.

¹⁰ \$13,413 (Revised Routine Maintenance Fee Expense) - \$5,940 (Commission Staff's Original Expense Level) = \$7,473.

¹¹ \$6,000 (Access Road – 2012) + \$7,800 (Access Road – 2014) + \$975 (Access Road Gate – 2014) = \$14,775.

years, resulting in an annual expense of \$422 and a reduction to depreciation expense of \$1,753.¹² Commission Staff further found that the disinfection system installed in 2015 should be depreciated over ten years, resulting in an increase to depreciation expense of \$227.¹³ Commission Staff's combined net decrease to depreciation expense was \$1,526.

In its response to the Staff Report, Oldham Woods explains that its "most critical need for smooth operations and compliance with environmental regulations is adequate cash flow."¹⁴ According to Oldham Woods, by increasing the depreciation/amortization lives of major expenditures, Commission Staff is extending the recovery period and the resulting delay in the cost recovery will "severely hamper the viability of small privately-owned systems, particularly because small systems lack the ready access to funding that is available to public systems or large investor-owned utilities."¹⁵ Oldham Woods is requesting the Commission Staff to reconsider its finding regarding the 35-year depreciation life for the gravel access road.

In reviewing prior Commission decisions, Commission Staff notes Case No. 2015-00428,¹⁶ in which Wood Creek Water District was allowed to depreciate a "Road to Sludge Dump" over 20 years. Given this precedent, Commission Staff is revising its

¹² \$422 (Commission Staff Depreciation) - \$2,175 (Test-Year Depreciation) = \$1,753.

¹³ \$2,270 (Disinfection System) ÷ 10 (Years) = \$227.

¹⁴ Oldham Woods' Response to the Commission Staff Report filed July 26, 2016 at 2.

¹⁵ *Id.* at 3.

¹⁶ Case No. 2015-00428, *Application of Wood Creek Water District for Rate Adjustment Pursuant to 807 KAR 5:076* (Ky. PSC July 14, 2016), Application, Tax Asset Detail at 5.

depreciation life for the gravel access road from 35 years to 20 years, resulting in an increase to depreciation expense of \$317.¹⁷

In its responses to the Staff Report, Oldham Woods provided an invoice showing that on July 21, 2016, it purchased an aerator from Aquatic Control, Inc. for \$3,744. In its August 25, 2016 filing, Oldham Woods provided a copy of a Camden invoice showing that the aerator was installed on August 24, 2016, at a cost of \$1,020. The O&M Guide for the Support of Rural Water-Wastewater Systems by Commissions on Rural Water, Chicago, Illinois, 1974, has a depreciation life range of five years to ten years for aerators.¹⁸ Using the mid-point of 7.5 years and the total cost of the aerator of \$4,764, Commission Staff is increasing its original depreciation expense by an additional \$635,¹⁹ for a combined increase of \$952.²⁰

(A) Amortization. Oldham Woods proposed a pro forma amortization expense of \$2,947 as calculated below.

Description	Cost	Years	Pro Forma Amortization
Rate Case Expense	\$ 2,700	3	\$ 900
Kentucky Pollution Discharge Elimination System	2,200	5	440
Post Test Year Repairs	7,408	5	1,482
Nonrecurring Labor	1,250	10	125
Total Pro Forma Amortization Expense	\$ 13,558		\$ 2,947

¹⁷ \$14,775 (Gravel Access Road) ÷ 20 (years) = \$739 - \$422 (Original Finding) = \$317.

¹⁸ Table 44, Average Service Lifetimes, Major Systems Components, Wastewater Systems, pages 246–247.

¹⁹ \$3,744 (Aerator Cost) + \$1,020 (Installation Cost) = \$4,764 ÷ 7.5 (Years) = \$635.

²⁰ \$317 (Gravel Access Road) + \$635 (Aerator) = \$952.

As shown below, Commission Staff calculated total pro forma amortization expense to be \$1,551.

	Original Cost	Original Report	
		Life	Amortization
Rate Case	\$ 2,700	5	\$ 540
KPDES Permit Fee	2,200	5	440
Post Test Year Plant	5,707	10	571
Commission Staff Adjustment			<u>\$ 1,551</u>

In its responses to the Staff Report, Oldham Woods provided an invoice from R&R Septic & Excavation, LLC showing that the bank repair had been completed on July 22, 2016, at a cost of \$1,800. Given that the majority of the post-test-year repairs were associated with the aerators, Commission Staff is reducing the amortization period from 10 to 7.5 years. Amortizing the post-test-year repairs of \$7,507²¹ over 7.5 years results in an increase to amortization expense of \$430.²²

Determination of Allowable Net Operating Income (“NOI”)

Using the operating ratio method, Commission Staff originally determined that Oldham Woods’ allowable NOI was \$7,369. In this amended report, Commission Staff has calculated a revised NOI of \$8,576. A comparison of the calculations is shown below.

²¹ \$1,800 (Bank Repair) +\$5,707 (Aerator Repair) = \$7,507.

²² \$7,507 ÷ 7.5 (Years) = \$1,001 - \$571 (Original Post Test Period Amortization) = \$430.

	<u>Report</u>	<u>Amended</u>
Operating Expenses	\$ 54,038	\$ 62,893
Divide by: Operating Ratio	<u>88%</u>	<u>88%</u>
Operating Revenue	61,407	71,469
Less: Operating Expenses	<u>(54,038)</u>	<u>(62,893)</u>
Allowable NOI	<u>\$ 7,369</u>	<u>\$ 8,576</u>

Calculation of Overall Revenue Requirement
and Required Revenue Increase

To recover all of its pro forma operating expenses and to generate the allowable NOI, Commission Staff originally determined that Oldham Woods required an overall revenue requirement of \$61,407, which required a \$6,869 revenue increase, or an increase of 12.595 percent. Commission Staff has now determined that to cover the revised operating expenses and NOI, Oldham Woods requires an overall revenue requirement of \$71,469, which requires a \$16,931 revenue increase, or an increase of 31.044 percent. A comparison of the calculations is shown below.

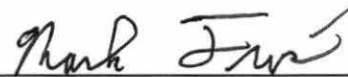
	<u>Report</u>	<u>Amended</u>
Operating Expenses	\$ 54,038	\$ 62,893
Allowable NOI	<u>7,369</u>	<u>8,576</u>
Revenue Requirement	61,407	71,469
Less: Pro Forma Present Rate Revenues	<u>(54,538)</u>	<u>(54,538)</u>
Required Revenue Increase	<u>\$ 6,869</u>	<u>\$ 16,931</u>
Percentage	<u>12.595%</u>	<u>31.044%</u>

Rate Calculated by Commission Staff

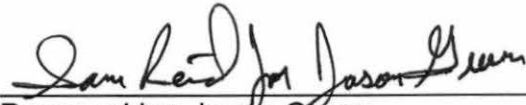
Oldham Woods currently charges a flat monthly rate of \$36.07 for a single-family residential customer. Oldham Woods requested to increase its flat monthly rate by

\$8.08 to \$44.15. Using its revised revenue requirement of \$71,469, Commission Staff calculates a flat monthly rate of \$47.27.²³

Signatures:



Prepared by: Mark Frost
Financial Analyst, Water and Sewer
Revenue Requirements Branch
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Prepared by: Jason Green
Rate Analyst, Water and Sewer
Rate Design Branch
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²³ \$71,469 (Revised Revenue Requirement) ÷ 12 (Months) ÷ 126 (Customers) = \$47.27.

APPENDIX A
STAFF REPORT, CASE NO. 2016-00131
RATE REQUESTED BY OLDHAM WOODS

Monthly Sewer Rate

\$44.15 per residential equivalent

APPENDIX B
STAFF REPORT, CASE NO. 2016-00131
REVISED RATE CALCULATED BY COMMISSION STAFF

Monthly Sewer Rate

\$47.27 per residential equivalent

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