

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF CLEARWATER DISPOSAL,	)	
INC. FOR A RATE ADJUSTMENT PURSUANT TO	)	CASE NO.
THE ALTERNATIVE RATE FILING PROCEDURE	)	92-242
FOR SMALL UTILITIES	)	

O R D E R

On June 10, 1992, Clearwater Disposal, Inc. ("Clearwater") filed its application for Commission approval of a proposed increase in its rates for sewer service. Commission Staff, having performed a limited financial review of Clearwater'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, this case will be submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this 19th day of August, 1992.

PUBLIC SERVICE COMMISSION

  
For the Commission

ATTEST:

  
Executive Director

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED

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PUBLIC SERVICE  
COMMISSION

In the Matter of:

THE APPLICATION OF CLEARWATER DISPOSAL, )  
INC. FOR A RATE ADJUSTMENT PURSUANT TO ) CASE NO. 92-242  
THE ALTERNATIVE RATE FILING PROCEDURE )  
FOR SMALL UTILITIES )

STAFF REPORT

Prepared By: Jack Scott Lawless, CPA  
Public Utility Financial  
Analyst  
Water and Sewer Revenue  
Requirements Branch

Prepared By: Nicky Moore  
Public Utility Rate Analyst  
Communications, Water and  
Sewer Rate Design Branch  
Research Division

STAFF REPORT

ON

CLEARWATER DISPOSAL, INC.

CASE NO. 92-242

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PUBLIC SERVICE  
COMMISSION

A. Preface

On June 10, 1992, Clearwater Disposal, Inc. ("Clearwater") submitted its application to the Public Service Commission ("Commission") seeking approval to increase its tariffed rates by 45 percent, an increase in annual operating revenues of \$5,280.

In order to evaluate the requested increase, the Commission Staff ("Staff") chose to perform a limited financial review of Clearwater's operations for the test period, the twelve month period ending December 31, 1991. Jack Scott Lawless, CPA and Karen Harrod, CPA of the Commission's Division of Rates and Tariffs conducted the review on July 22, 1992 at Clearwater's office in Middlesboro, Kentucky. Nicky Moore of the Commission's Research Division performed a review of Clearwater's reported revenues at the offices of the Commission.

The findings of the field review have been reduced to writing in this report. Mr. Moore is responsible for the sections related to operating revenues and rate design. The remaining sections of this report were prepared by Mr. Lawless. Based upon the findings of this report, Staff recommends that Clearwater be allowed to increase its annual revenues by \$5,306.

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.

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

#### B. Determination of Adjusted Test Period Operations

##### Operating Revenue

Clearwater reported test-year revenue of \$11,162.00. Its application indicates that, at the time of filing, it had 110 customers. This number of customers would generate \$11,642.40 in revenue annually at current rates, a difference of \$480.40 over actual test-period revenue collected.

##### Operating Expenses

Clearwater reported operating expenses of \$12,592 for the test year which it proposed to increase by \$4,725. Staff has calculated pro forma adjustments to the operating expenses in the amount of \$1,929. Staff's adjustments are shown on Appendix B attached to this report. Clearwater's and Staff's pro forma adjustments to test period operations are discussed in the following sections of this report.

##### Fuel and Power / Treatment and Disposal

Clearwater reported test year fuel and power expense and treatment and disposal expense of \$5,128 and \$930, respectfully.

Clearwater proposed to increase these accounts by 5% but has not provided Staff with a foundation to make either of these adjustments. These adjustments are not known and measurable and should not be considered for rate making purposes. However, during Staff's review it was determined that 12 months of expenses were not reflected in these accounts. To annualize these expenses, Staff recommends adjustments to increase test year fuel and power expense and treatment and disposal expense by \$248<sup>1</sup> and \$81<sup>2</sup>, respectively.

Maintenance - Routine

Clearwater reported test year maintenance - routine expense of \$2,400. Included in this account is the amount Clearwater paid to its contract operator as well as miscellaneous expenses. In its application Clearwater proposed to increase the contract fee by 10%. As of the date of Staff's field review there had been no new contract negotiations, therefore, Staff recommends that Clearwater's adjustment be disallowed. However, during Staff's investigation it was determined that only 11 payments to the

<sup>1</sup>				
Pro forma				\$ 5,376
Less: Test year				<u>(5,128)</u>
Adjustment				<u>\$ 248</u>
<sup>2</sup>				
<u>Date</u>	<u>Date</u>	<u>Vendor</u>	<u>Amount</u>	
<u>Paid</u>	<u>Invoice</u>			
1-2-92	11-29-91	McCoy & McCoy	\$	40.25
1-2-92	12-20-91	McCoy & McCoy		<u>40.25</u>
Adjustment				<u>\$ 80.50</u>

contractor were included in operating expenses during the test year. Thus, Staff recommends an increase to annualize this expense in the amount of \$200<sup>3</sup>.

Maintenance - Structures and Improvements

During the test year Clearwater reported maintenance - structures and improvements expense of \$2,555. Clearwater proposed to increase this amount by \$1,200 for estimated increases in expenses. This adjustment is not known and measurable and should not be considered for rate making purposes. Clearwater also adjusted this account by \$1,200 for the purchase of a pump on February 19, 1992 which was outside of the test year. This adjustment is related to a capital expenditure which should be capitalized and not included as an operation and maintenance expense when calculating pro forma revenue requirements.

Staff has adjusted this account to reflect the capitalization of a pump that was purchased within the test year. The cost of that pump was \$2,027 which was eliminated from test year operation and maintenance expenses but will be recovered by an adjustment to test year depreciation expense.

<sup>3</sup>	Monthly Contract	\$	200
	Annualize		<u>12</u>
	Pro forma		2,400
	Less: Test year		<u>(2,200)</u>
	Adjustment	\$	<u>200</u>

Maintenance - Plant

For the test year, Clearwater reported maintenance - plant expense of \$480. During the first five months of 1992, Clearwater incurred maintenance - plant expenses of \$720. Based on the increased expenses incurred in 1992, Clearwater proposed an adjustment to reflect additional maintenance - plant expenses of an estimated \$1,200 over the test-year level. This does not meet the known and measurable requirement employed by this Commission. Therefore, staff is of the opinion that this adjustment should not be accepted for rate making purposes.

Office Supplies and Miscellaneous

Clearwater increased both office supplies and miscellaneous expense accounts by 10%. These adjustments are not known and measurable and should not be considered for rate making purposes. However, during Staff's review it was discovered that Clearwater's accountant increased its annual fee from \$455 to \$487.50 for services rendered. Accordingly, Staff has increased office supplies expense by \$33<sup>4</sup>.

Owner/Manager Fee

Staff is of the opinion that Clearwater is entitled to an owner/manager fee in the amount of \$2,400. A fee of this nature is

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<sup>4</sup>	Pro forma	\$ 487.50
	Less: Test year	<u>(455.00)</u>
	Adjustment	<u>\$ 32.50</u>

generally allowed by this Commission. Accordingly, operating expenses have been increased \$2,400.

Depreciation

Staff has adjusted test year operating expenses to allow Clearwater to recover the cost of two pumps through depreciation. Pump #1 was purchased on July 10, 1991, and the cost has been eliminated from test year operation and maintenance expenses by Staff. Pump #2 was purchased on February 19, 1992, which was after test-year-end, but this expenditure should still be recovered through pro forma depreciation expense. After consulting with the Commission's Engineering Division, Staff determined that the pumps should be depreciated over a five year period. Thus, depreciation expense has been increased by \$650<sup>5</sup>.

Property Taxes

Clearwater adjusted test year property taxes by estimating an increase of \$23. This adjustment is not known and measurable and should not be considered for rate making purposes. During Staff's investigation it was discovered that property taxes paid in 1992 to

<sup>5</sup>	Pump capitalized	\$ 2,027
	Post test year pump	<u>1,225</u>
	Total	3,252
	Divide by: Five	<u>5</u>
	Adjustment	<u>\$ 650</u>



the county had decreased by \$155<sup>6</sup>. An adjustment was made to reflect this decrease in expense.

Regulatory Commission Expense

Clearwater adjusted test year regulatory commission expense by \$500<sup>7</sup>. This adjustment reflects the 5 year amortization of the \$2,500 cost of the Kentucky Pollutant Discharge Elimination System Permit required by the Division of Water. Staff agrees with this adjustment and has incorporated it into the rates recommended in this report.

C. Revenue Requirements

The approach frequently used by this Commission to determine revenue requirements for small, privately owned utilities is the operating ratio. This approach is used primarily when there is no basis for rate of return determination or the cost of the utility plant has fully or largely been recovered through the receipt of contributions. Staff recommends the use of this approach in determining Clearwater's revenue requirements in this case.

<sup>6</sup>	Pro forma	\$ 226
	Less: Test year	<u>(381)</u>
	Adjustment	<u>(155)</u>
<sup>7</sup>	Permit fee	\$ 1,500
	Engineering fee	<u>1,000</u>
	Total cost	2,500
	Amortize over life of permit	<u>5</u>
	Annual recovery	500
	Less: Test year	<u>(0)</u>
	Adjustment	<u>\$ 500</u>

Staff's adjusted operations provide Clearwater with an operating ratio of 124.73%<sup>8</sup>. Combined with Petitioner's proposed increase of \$5,280, the result is an operating ratio of 85.81%<sup>9</sup>.

Staff is of the opinion that an 88% operating ratio would allow Petitioner sufficient revenues to cover its operating expenses and to provide for equity growth. In this proceeding, an operating ratio of 88% and an allowance for the appropriate state and federal income taxes results in a revenue requirement of \$16,948<sup>10</sup>. Staff recommends that Clearwater be allowed to increase its annual operating revenue by \$5,306<sup>11</sup>.

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<sup>8</sup>      $\$14,521 / \$11,642 = 124.73\%$

<sup>9</sup>      $\$14,521 / (\$11,642 + \$5,280) = 85.81\%$

<sup>10</sup>	Recommended operating expense	
	before income taxes	\$ 14,522
	Divide by: Operating ratio	<u>88%</u>
	Required revenue before tax	16,502
	Less: Recommended operating expense	
	before income taxes	<u>(14,522)</u>
	Required margin subject to tax	1,980
	Times: Gross up factor	<u>1.2255</u>
	Required net operating income	
	before income taxes	2,427
	Add: Recommended operating expense	<u>14,521</u>
	Required revenue	<u>\$ 16,948</u>
<sup>11</sup>	Revenue requirement	\$ 16,948
	Less: Normalized revenues	<u>(11,642)</u>
	Required increase in revenues	<u>\$ 5,306</u>

D. Rate Design

Under the existing rate schedule, all residential customers are paying a flat rate.

Using the proposed rate design, Staff has developed rates that will produce \$16,948, the revenue required to meet annual operating expenses. Therefore, Staff recommends that the schedule of rates in Appendix A be approved for services rendered.

E. Signatures

Jack Scott Lawless, CPA  
Prepared By: Jack Scott Lawless, CPA  
Public Utility Financial  
Analyst  
Water and Sewer Revenue  
Requirements Branch  
Rates and Tariffs

Nicky Moore  
Prepared By: Nicky Moore  
Public Utility Rate Analyst  
Communications, Water and  
Sewer Rate Design Branch  
Research Division

APPENDIX A  
TO STAFF REPORT CASE NO. 92-242

The Staff recommends the following rate be prescribed for customers of Clearwater Disposal, Inc.

<u>Customer Class</u>	<u>Rates</u>
Residential (Single Family)	\$12.84 per month

APPENDIX E  
TO STAFF REPORT FOR CASE NO. 92-242

Clearwater Disposal, Inc.  
Statement of Adjusted Operations

	Test Year	Adjustments	Test Year Adjusted
Operating revenue	\$11,162	\$480	\$11,642
Operating expenses			
Operation and Maintenance			
Fuel and power	5,128	248	5,376
Treatment and disposal	930	81	1,011
Maintenance - routine	2,400	200	2,600
Maintenance - Str. and Imp.	2,555	(2,027)	528
Maintenance - Plant	480		480
Office supplies	455	33	488
Miscellaneous	132		132
Owner/Manager fee		2,400	2,400
Total Oper. and Maint.	12,080	934	13,014
Depreciation	0	650	650
Taxes Other Than Income Taxes			
Property	447	(155)	292
PSC assessment	50		50
Filing fee	15		15
KPDES		500	500
Total Taxes Other Than Income Taxes	512	345	857
Total Operating Expenses Before Income Taxes	12,592	1,929	14,521
Net Operating Income Before Income Taxes	(\$1,430)	(\$1,449)	(\$2,879)