

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF SCHMIDT, INC. FOR A)	
RATE ADJUSTMENT PURSUANT TO THE)	CASE NO.
ALTERNATIVE RATE FILING PROCEDURE FOR)	92-370
SMALL UTILITIES)	

O R D E R

On August 24, 1992, Schmidt, Inc. ("Schmidt") filed its application for Commission approval to increase its water rates. Commission Staff, having performed a limited financial review of Schmidt'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, then this case will be submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this 12th day of November, 1992.

PUBLIC SERVICE COMMISSION


For the Commission

ATTEST:


Executive Director

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF SCHMIDT, INC.)	
FOR A RATE ADJUSTMENT PURSUANT TO)	CASE NO. 92-370
THE ALTERNATIVE RATE FILING)	
PROCEDURE FOR SMALL UTILITIES)	

STAFF REPORT

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STAFF REPORT

ON

SCHMIDT, INC.

CASE NO. 92-370

A. Preface

On August 24, 1992, Schmidt, Inc. ("Schmidt") filed its application with the Kentucky Public Service Commission ("Commission") seeking approval to increase its tariffed sewer rates by 33.3 percent, an increase in annual operating revenues of \$7,500.

In order to evaluate the requested increase, the Commission Staff ("Staff") chose to perform a limited financial review of Schmidt's operations for the test period, the twelve month period ending December 31, 1991. Jack Scott Lawless, CPA, of the Commission's Division of Rates and Tariffs conducted the review on October 1, 1992 at Schmidt's office in Henderson, Kentucky. Etta Townsend of the Commission's Research Division performed a review of Schmidt's reported revenues at the offices of the Commission.

The findings of the field review have been reduced to writing in this report. Ms. Townsend 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 Schmidt be allowed to increase its normalized operating revenues by \$5,567.

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, Schmidt 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 Revenue

Schmidt reported test-year revenues of \$22,969. Its application indicates that, at the time of filing, it had 100 customers. This number of customers would generate \$22,500 in revenue annually at current rates, a difference of \$469 under actual test-period revenue collected. The difference between reported and generated revenues can be attributed to a loss of 3 customers during the test-year. For this filing, the Commission recognizes the \$22,500 collected from rates as the normalized operating revenues for the test-period and foreseeable future. Additionally, \$450 were collected for late charges. Total adjusted operating revenues for the period totalled \$22,950.

Operating Expenses

Schmidt reported operating expenses of \$23,286 for the test year which it proposed to increase by \$5,964. Staff has calculated pro forma adjustments to the operating expenses in the amount of \$1,810. Staff's adjustments are shown on Appendix B attached to this report. Schmidt's and Staff's pro forma adjustments to test period operations are discussed in the following sections of this report.

Salaries and Wages

Schmidt reported test year salaries and wages expense of \$6,028 which it proposed to increase by \$2,872 to reflect the current salaries being paid to its employees. Staff agrees with this adjustment and has adjusted test year salaries and wages by \$2,872¹.

Utilities

Schmidt reported test year purchased power and purchased water of \$3,534. Schmidt proposed to increase test year utilities by \$266 for future increases in the rates charged by its suppliers. This adjustment does not meet the known and measurable requirement employed by this Commission and has therefore been disallowed by Staff for the purpose of setting rates in these proceedings. During Staff's financial review of Schmidt there were no pro forma adjustments identified when analyzing the utilities account that would have a material impact on the revenue requirements recommended by Staff, therefore, no additional adjustments were recommended to test year utilities expense.

Maintenance of Plant

¹	Office Manager/Monthly Salary	\$	200
	Annualize		<u>12</u>
	Sub-total		<u>2,400</u>
	Plant Operator/Weekly Salary		125
	Annualize		<u>52</u>
	Sub-total		<u>6,500</u>
	Pro forma		8,900
	Less: Test year		<u>(6,028)</u>
	Adjustment	\$	<u>2,872</u>

Schmidt reported test year maintenance of plant expense of \$4,299 which it proposed to increase by \$1,702. This adjustment, as explained by Schmidt in its application, is for the increase in chemical expenses, an increase in testing costs and an allowance for contract labor. Due to the ambiguous nature of Schmidt's adjustment, Staff was unable to make a determination as to its reasonableness. Therefore, Staff chose to disregard Schmidt's adjustment while analyzing the maintenance of plant expense account in order to make pro forma adjustments.

During Staff's analysis of the maintenance of plant expense account, Staff discovered that Schmidt made payments to Mr. Frank McCormick for contractual services related to maintenance of the plant totaling \$1,738. Mr. McCormick no longer provides maintenance services to Schmidt and Schmidt has indicated to Staff that it does not intend to replace him with another serviceman. Therefore, Staff has eliminated the payments made to Mr. McCormick from test year operating expenses in the determination of pro forma revenue requirements.

Staff has also adjusted this account to allow Schmidt to recover an increase in chemical costs. At the request of the Division of Water ("DOW") Schmidt has switched from a grab test to a composite test to more accurately evaluate its discharge. Composite testing requires the use of more chlorine than grab testing. In determining what amount was reasonable for the recovery of pro forma chemical costs, Staff analyzed chemical purchases made in 1992 while Schmidt was using the composite test. Staff discovered that through September, 1992 Schmidt had already spent \$743 on chemicals. Staff then added the cost of chlorine to be

purchased in October and December totaling \$230 to arrive at its pro forma chemical expense. Staff has made the appropriate adjustment to operating expenses of \$715² to properly reflect pro forma chemical expenses.

Postage and Supplies

Schmidt has made arbitrary adjustments to both postage and supplies expenses which could not be supported. Since these adjustments fail to meet the criteria of being known and measurable, Staff recommends that they be disallowed for rate making purposes.

Truck

During the test year Schmidt reported mileage paid to Mr. Frank McCormick of \$88. Schmidt did not record mileage as an expense for trips made by the office manager and plant operator even though they used their personal automobiles. Schmidt now is requesting that these employees be reimbursed for their mileage and has made a pro forma adjustment of \$112 to test year operating expenses. Schmidt's adjustment was based on its own mileage estimate. This adjustment is not known and measurable and should therefore be disallowed for rate making purposes. However, Staff is of the opinion that Schmidt's employees are entitled to be reimbursed for the use of their personal automobiles. In order to determine a reasonable level of pro forma mileage expense, Staff determined the number of miles Schmidt would have

²	Pro forma	\$	973
	Less: Test year		(258)
	Adjustment	\$	<u>715</u>

been responsible for during the most recent twelve month period. Staff discovered that from October, 1991 through September, 1992 the Office Manager and Plant Operator drove 1,298 miles on business related to Schmidt's operations. Staff applied the allowable mileage rate used for federal tax calculations of \$.28 per mile to 1,298 miles to calculate a pro forma mileage expense of \$363. Accordingly, Staff has adjust test year operating expenses by \$275³ to reflect the pro forma mileage expense.

Insurance

Schmidt reported test year insurance expense of \$1,274 which it proposed to increase by \$226. Staff was unable to determine a basis for Schmidt's adjustment and is recommending that it not be considered for rate making purposes in this case. However, during Staff's review it was discovered that workers compensation insurance premiums had increase during 1992. Staff has taken this into consideration and has adjusted test year insurance expense by \$66⁴.

Miscellaneous

Schmidt reported test year miscellaneous expense of \$605. Schmidt proposed to increase this expense by \$45 due to increases in wastewater associations dues, seminars, fire protection, bank charges, small tools,

³	Pro forma	\$	363
	Less: Test year		<u>(88)</u>
	Adjustment	\$	<u>275</u>
⁴	Pro forma	\$	898
	Less: Test year		<u>(832)</u>
	Adjustment	\$	<u>66</u>

operator's licenses, etc. Schmidt did not provide any information to Staff showing that the \$45 dollar adjustment was known and measurable. Therefore, Staff has recommended that this adjustment be disallowed for rate making purposes.

Furthermore, included in this account was \$53 for flowers from O'Daniel Flowers. Staff is of the opinion that the ratepayers received no benefit from this expenditure and therefore the cost should not be borne by them. Accordingly, Staff recommends an adjustment be included to decrease operating expense by \$53.

Rate Case Expense

During the test year Schmidt reported \$365 of rate case expense. This expense was included in the test year due to the late billing of Schmidt's accountant for services rendered in Schmidt's previous rate case in 1987. Schmidt then adjusts this amount by \$385 which results in an annual recovery of \$750 annually. Schmidt justified this recovery as a conservative estimate since the last rate case cost Schmidt \$880. However, this alternative rate filing ("ARF") was prepared by the office manager, not an accountant, which will drastically reduce the cost of the ARF. Furthermore, Schmidt's adjustment does not take into consideration the amortization of rate case expenses which is a rate making methodology used by this Commission. Therefore, Staff is of the opinion that Schmidt's adjustment be disallowed for determining revenue requirements in this case.

Staff has calculated an annual recovery based on the actual rate case expense incurred by Schmidt up through September, 1992. The actual

rate case expense was \$105 which Staff proposes to amortize over a three year period resulting in a pro forma adjustment of (\$330)⁵. Staff's adjustment does not include any estimates for attorney fees or consulting fees which will be incurred and should be recovered through rates if proceedings in this matter continue. Therefore, an additional pro forma adjustment may be required.

Depreciation

Schmidt adjusted test year depreciation expense by \$122 for depreciation on any equipment to be purchased in the near future. Staff is of the opinion that this adjustment should not be allowed in this proceeding as it is not known and measurable.

Taxes Other Than Income Taxes

Schmidt proposed to increase test year miscellaneous taxes and payroll taxes by \$32 and \$35, respectively. These adjustments are not known and measurable and should therefore not be considered for rate making purposes. Staff has made a minimal adjustment to payroll taxes of \$1. This adjustment does not have a material impact on the revenue requirements recommended in this report but it is an adjustment that should be made in conjunction with a salary and wage adjustment as made previously in this report.

⁵	Rate Case Expense	\$	105
	Amortize	+	<u>3</u>
	Annual Recovery		35
	Less: Test year		<u>(365)</u>
	Adjustment		<u>(330)</u>

C. Revenue Requirements Determination

The approach frequently used by this Commission to determine revenue requirements for small, privately owned utilities is an 88 percent operating ratio. Staff recommends the use of this approach in determining Schmidt's revenue requirements.

When using the approach recommended by Staff, Schmidt's revenue requirements are \$28,518⁶. Staff recommends that Schmidt be allowed to increase its normalized operating revenue by \$5,567⁷.

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 \$28,080, the revenue required to meet annual operating expenses. Therefore, Staff recommends that the schedule of rates in Appendix A be approved for services rendered.

⁶	Pro forma Operating Expenses	\$ 25,095
	Divide by: Operating Ratio	<u>88%</u>
	Required revenue	<u>\$ 28,517</u>
⁷	Revenue requirement	\$ 28,517
	Less: Normalized revenues	(22,500)
	Other Operating Revenue	<u>(450)</u>
	Required increase in revenues	<u>\$ 5,567</u>

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E. Signatures

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APPENDIX A
TO STAFF REPORT CASE NO. 92-370

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

<u>Customers Class</u>	<u>Rates</u>
Residential (Single Family)	\$23.40 per month

APPENDIX B
TO STAFF REPORT FOR CASE NO. 92-370

Schmidt, Inc.
Statement of Adjusted Operations

	Test Year	Adjustments	Pro forma Present Rates
Operating Revenue			
Flat Rate Revenue	\$22,969	(\$469)	\$22,500
Late Charge	450		450
Total Operating Revenue	23,419	(469)	22,950
Operating Expenses			
Operation and Maintenance			
Salaries and Wages	6,028	2,872	8,900
Contractual Services	2,400		2,400
Utilities	3,534		3,534
Maintenance of Plant	4,299	(1,738)	2,561
Postage	499		499
Supplies	134		134
Truck Expense	88	275	363
Insurance	1,274	66	1,340
Miscellaneous Expense	605	(83)	522
Amortization of Permit	300		300
Rate Case Expense	365	(330)	35
Total Operation and Maintenance	19,526	1,807	21,333
Depreciation	1,378		1,378
Taxes Other Than Income			
Payroll Taxes	965	1	966
Miscellaneous Taxes	418		418
Total Taxes Other Than Income	1,383	1	1,384
Total Operating Expenses	23,287	1,808	25,095
Net Operating Income	\$132	(\$2,277)	(\$2,145)