

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

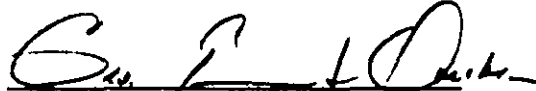
THE APPLICATION OF WAVERLY SANITATION, )  
INC. FOR A RATE ADJUSTMENT PURSUANT ) CASE NO. 93-002  
TO THE ALTERNATIVE RATE FILING )  
PROCEDURE FOR SMALL UTILITIES )

O R D E R

On January 4, 1993, Waverly Sanitation, Inc. ("Waverly") 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 Waverly's operations, has prepared the attached Staff Report containing Staff's findings and recommendations regarding Waverly's 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 17th day of March, 1993.

PUBLIC SERVICE COMMISSION

  
For the Commission

ATTEST:

  
Executive Director

COMMONWEALTH OF KENTUCKY  
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THE APPLICATION OF WAVERLY SANITATION, )  
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STAFF REPORT

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

Prepared By: Brent Kirtley  
Public Utility Rate  
Analyst  
Communications, Water  
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Division of Rates and Research

STAFF REPORT

ON

WAVERLY SANITATION, INC.

CASE NO. 93-002

A. Preface

On January 4, 1993, Waverly Sanitation, Inc. ("Waverly") filed its application with the Kentucky Public Service Commission ("Commission") seeking approval to increase its tariffed sewer rates by 20 percent, an increase in annual operating revenues of \$3,367.

In order to evaluate the requested increase, the Commission Staff ("Staff") chose to perform a limited financial review of Waverly's operations for the test period, the twelve month period ending December 31, 1991. Jack Scott Lawless of the Commission's Division of Financial Analysis conducted the review on January 28, 1993 at Waverly's office in Louisville, Kentucky. Brent Kirtley of the Commission's Division of Rates and Research performed a review of Waverly's reported revenues at the offices of the Commission.

The findings of the field review have been reduced to writing in this report. Mr. Kirtley 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 Waverly be allowed to increase its normalized operating revenues by \$11,114 or 69.32%.

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, Waverly 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

Waverly reported test year revenue of \$16,835 in their 1991 annual report. However, this amount inadvertently included sales taxes of \$691. Service is currently provided to 20 four-plex apartment buildings and one building of 14 residential row houses. This customer base at the current tariffed rates should generate \$16,032 in revenue. Therefore, for the purposes of this report, normalized test-year revenue shall be considered to be \$16,032.

##### Operating Expenses

Waverly reported operating expenses of \$19,095 in the 1991 annual report and \$19,762 on page 2 of the alternative rate filing application. This reporting difference is attributed to the inclusion of a note payment of \$3,000 reported as a test year expense and the exclusion of taxes other than income taxes of \$2,333 on page 2 of the alternative rate filing application. On page 2 of its application Waverly proposed to increase operating expenses by \$3,931 while Staff has calculated pro forma adjustments to the operating expenses in the amount of \$3,690. Staff's adjustments are shown on Appendix B attached to this report.

Waverly's and Staff's pro forma adjustments to test period operations are discussed in the following sections of this report.

Sludge Hauling

Waverly reported test year sludge hauling expense of \$580 which it proposed to increase by \$711. This adjustment was made to reflect one load of sludge per quarter at the most current rate charged for sludge hauling. During the test year only two loads of 5,000 gallons were hauled for \$290 per load. However, in 1992 four 5,000 gallon loads of sludge were hauled at a rate of \$322.75. During its review Staff reviewed all the sludge hauling invoices for the test year and 1992 and is in agreement with Waverly's adjustment. Staff has incorporated this adjustment into its calculation of revenue requirements in Appendix B.

Maintenance

During the test year Waverly reported an expense of \$540 for quarterly lab reports. However, as of 1992, Waverly has been required to file monthly lab reports. The cost of the monthly report is \$135. Although this adjustment was not considered in Waverly's application, Staff has included it in its calculation of recommended revenue requirements by making an adjustment to operating expenses of \$1,080<sup>1</sup>.

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<sup>1</sup> Monthly lab report	\$	135
Annualize		<u>12</u>
Pro forma		1,620
Less: Test year		<u>(540)</u>
Adjustment	\$	<u>1,080</u>

Waverly increased maintenance expense by \$400 for road maintenance. Staff is in agreement that this is an annual expense for Waverly and that \$400 at the pro forma level is an appropriate amount. However, Staff has netted the \$400 pro forma amount with what was expensed on road maintenance during the test year by adjusting operating expense by \$127<sup>2</sup>.

In the maintenance expense account Waverly had expensed the cost of purchasing and installing one chlorinator in the amount of \$250. Staff is of the opinion that this expenditure will benefit Waverly and its customers for a period of more than one year. Therefore, Staff has eliminated the cost of the chlorinator from test year maintenance expense and made an adjustment to test year depreciation expense to allow the appropriate recovery of cost.

Waverly made an adjustment to operating expenses of \$3,400 for system improvements which include painting, grating and a flow meter. Staff is of the opinion that the requested improvements should be allowed and recovered through rates but not over a one year period as requested. Instead, Staff has included a recovery of these items in its calculation of pro forma depreciation expense.

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<sup>2</sup> Pro forma	\$	400
Less: Test year		<u>273</u>
Adjustment	\$	<u>127</u>

After discussion with the Division of Engineering, Staff has adjusted test year operation and maintenance expenses by \$900<sup>3</sup> to reflect Waverly's proposal to install one diffuser every other month at a cost of \$150 per month.

Owner/Manager Fee

During the test year Waverly report \$1,800 for administrative fees; however, it has subsequently requested that an annual fee of \$2,400 be considered. Staff is of the opinion that Waverly is entitled to an owner/manager fee in the amount of \$2,400. A fee of this nature is generally allowed by this Commission. Accordingly, operating expenses have been increased by \$600<sup>4</sup>.

KPDES Permit

Staff has amortized the cost of the KPDES discharge permit of \$1,700 over the five year life of the permit resulting in a \$340<sup>5</sup> adjustment to test year operation and maintenance expenses.

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<sup>3</sup>	Installation cost of one diffuser	\$	150
	Times: six installations a year		<u>6</u>
	Adjustment	\$	<u>900</u>
<sup>4</sup>	Pro forma	\$	2,400
	Less: Test year		<u>(1,800)</u>
	Adjustment	\$	<u>600</u>
<sup>5</sup>	Pro forma cost of permit	\$	1,700
	Divide by: life of permit		<u>5</u>
	Adjustment	\$	<u>340</u>

Depreciation

Staff has adjusted test year operating expense to allow Waverly to recover the cost of painting of the plant, grating, a flow meter, a chlorinator and a pump. After consulting with the Commission's Engineering Division, Staff determined that these items should be depreciated over a five year period. Thus, depreciation expense has been adjusted by \$873<sup>6</sup>.

Taxes Other Than Income Taxes

Waverly reported test year taxes other than income taxes of \$2,333. Of this amount \$691 was related to sales tax. Waverly is simply acting as an agent of the taxing authorities to collect and remit this tax. Accordingly, these monies should not be recorded as an operating revenue or expense of Waverly. As a result, Staff has made an adjustment to taxes other than income taxes of (\$691) to eliminate sales taxes from operating expenses.

C. Revenue Requirements Determination

Assuming that Waverly's request for a 20% rate increase were granted, a \$4,071 net operating loss would be recognized given pro forma revenues and expenses. Staff is of the opinion that Waverly should

<sup>6</sup> Painting (proposed)	\$	500
Grating (proposed)		453
Flow meter (proposed)		2,500
Chlorinator (purchased 1991)		250
Pump (purchase 1992)		661
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Total		4,364
Depreciable life: 5 years		5
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Adjustment	\$	<u>873</u>



operate on a stand alone basis, thus requiring no subsidization from its stockholders. Therefore, Staff recommends that Waverly's request be denied and that Waverly's revenue requirements be calculated using an approach frequently used by this Commission for small, privately owned utilities which is an 88 percent operating ratio plus a dollar for dollar recovery of the average interest paid over the next three years.

The approach recommended by Staff results in a \$27,146 pro forma revenue requirement calculated as follows:

Pro forma operating expenses	\$ 22,785
Divide by: 88% operating ratio	<u>88%</u>
Sub-total	25,892
Allowable interest	<u>1,254</u>
Revenue Requirement	<u>\$ 27,146</u>

The interest component of the revenue requirement was included by Staff as Waverly is currently paying \$250 per month to E-Z Construction ("E-Z") pursuant to the guarantee agreement of \$20,075 with E-Z which was executed as a result of the settlement in Case No. 85-CT-10180 brought before the 7th Division of the Jefferson Circuit Court. This obligation originated in October, 1980 when E-Z contracted with Waverly to perform a major repair of the treatment plant at a price of \$13,000. Upon delinquency of payment, legal action was taken by E-Z whereby interest on the outstanding balance began accruing. In August, 1988 the title of Waverly as well as the attached lien of E-Z was transferred to Mrs. Betty Farley. Mrs. Farley, as previously mentioned, is currently paying \$250 per month to E-Z. This payment is for principal and interest on the original \$13,000 contract and the interest for

delinquency in payment. Staff is of the opinion that the interest which was the result of delinquent payment should be borne by the stockholder and the interest on the original amount should be passed through to the consumer as would have been done when the contract was negotiated. Therefore, Staff has included only \$1,254 of the total \$1,937 three year average interest expense. The interest component was calculated as follows:

Interest for 1993	\$	2,061
" 1994		1,942
" 1995		1,807
		<u>1,937</u>
Average interest expense		1,937
Times: Percentage		<u>64.76%</u> <sup>7</sup>
Allowable interest	\$	<u>1,254</u>

Therefore, Staff recommends that Waverly be allowed to increase its normalized operating revenue to \$27,146<sup>8</sup>.

D. Rate Design

The application filed by Waverly included a schedule of present and proposed rates. Waverly currently has approved rates for apartments, residential and commercial customer classes, churches, and schools. However, the application did not include proposed rates for the commercial class, churches or schools since there are none of these

<sup>7</sup>	Original contract amount	\$	13,000
	Divide by: Original contract amount plus accrued interest		<u>20,075</u>
	Percentage allowable		<u>64.76%</u>
<sup>8</sup>	Pro forma proposed rate revenue	\$	27,146
	Less: Pro forma present rate revenue		<u>(16,032)</u>
	Adjustment	\$	<u>11,114</u>

customer classes in the service area and the area served is fully developed so no service will be provided to these classifications. Therefore, the rate schedule for these services has been deleted. Waverly serves 20 four-plex apartment buildings and one building of 14 residential row houses. The required revenue has been spread evenly among the 94 units. The rates in Appendix A are the rates recommended by Staff and will generate the revenue requirement of \$27,146.

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 Division

Brent Kirtley  
Prepared By: Brent Kirtley  
Public Utility Rate  
Analyst  
Communications, Water  
and Sewer Rate Design Branch  
Division of Rates and Research

**APPENDIX A  
TO STAFF REPORT CASE NO. 93-002**

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

<u>Classification</u>	<u>Monthly Rate</u>
Apartments	\$96.40 per four-plex building (or \$24.10 per unit)
Row Houses	\$337.40 per fourteen-unit building (or \$24.10 per unit)

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 93-002 DATED March 17, 1993.

The following rates and charges are prescribed for the customers in the area served by Waverly Sanitation, Inc. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

<u>Classification</u>	<u>Monthly Rate</u>
Apartments	\$96.40 per four-plex building (or \$24.10 per unit)
Row Houses	\$337.40 per fourteen-unit building (or \$24.10 per unit)

APPENDIX B  
10 STAFF REPORT FOR CASE NO. 93-000

Waverly Sanitation, Inc.  
Statement of Adjusted Operations

	Last Year	Adjustments	Pro forma Present Rate
Operating Revenues			
Sewage Revenues	\$16,835	(\$691) (112)	\$16,032
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Operating Expenses			
Operation and Maintenance			
Sludge hauling	580	711	1,291
Purchased water	2,373		2,373
Materials and supplies	1,080		1,080
Purchased power	3,204		3,204
Chemicals	478		478
Maintenance	4,110	1,080 (250) 127	
Owner manager fee	1,800	900	2,700
Office supplies	20	600	620
Outside Services	378		378
KPDES discharge permit		340	340
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Total Operation and Maintenance	14,023	3,508	17,531
Depreciation	2,739	873	3,612
Taxes Other Than Income Taxes	2,333	(691)	1,642
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Total Operating Expenses	19,095	3,690	22,785
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Net Operating Income	(\$2,260)	(\$4,493)	(\$6,753)
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