

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF RIVER BLUFFS, INC.)
FOR AN ADJUSTMENT OF RATES PURSUANT)
TO THE ALTERNATIVE RATE FILING) CASE NO. 95-365
PROCEDURE FOR SMALL UTILITIES)

O R D E R

On August 23, 1995, River Bluffs, Inc. ("River Bluffs") filed its application for Commission approval of proposed sewer rates. Commission Staff, having performed a limited financial review of River Bluffs' operations, has prepared the attached Amended 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 no more than 15 days from the date of this Order to provide written comments regarding the attached Amended 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 22nd day of March, 1996.

ATTEST:


Executive Director

PUBLIC SERVICE COMMISSION


For the Commission

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF RIVER)
BLUFFS, INC. FOR A RATE)
ADJUSTMENT PURSUANT TO THE) CASE NO. 95-365
ALTERNATIVE RATE FILING)
PROCEDURE FOR SMALL UTILITIES)

AMENDED
STAFF REPORT

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Public Utility Financial
Analyst, Chief
Water and Sewer Revenue
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Financial Analysis Division

Prepared By: Chris Smith
Public Utility Rate Analyst
Communications, Water
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STAFF REPORT

ON

RIVER BLUFFS, INC.

CASE NO. 95-365

On August 23, 1995 River Bluffs, Inc. ("River Bluffs") filed its application seeking to increase its rates pursuant to 807 KAR 5:076, the Alternative Rate Adjustment Procedure for Small Utilities ("ARF"). River Bluffs determined that its pro forma operations support a revenue requirement of \$93,624, and requested an increase in its revenue from rates of \$33,993.

On June 16 and 22, 1995 and July 26, 1995, the Commission Staff ("Staff") conducted a limited financial review of River Bluffs' test-period operations for the 1994 calendar year. On December 5, 1995, Staff issued its initial report recommending that River Bluffs be granted an increase to its annual operating revenues from rates of \$17,487. Staff also recommended that River Bluffs be granted a monthly surcharge to cover its short-term interest expense.

Both River Bluffs and the City of River Bluffs ("City") requested that an informal conference be held to discuss Staff's recommendations. An informal Conference was held at the Commissions offices on January 31, 1996. Based upon the issues raised at the informal conference, Staff has amended its Staff Report recommendations as shown in the operating statement set forth in Attachment A.

As shown in Attachment B, Staff's amended operations result in a total revenue requirement of \$72,965. Therefore, Staff recommends that River Bluffs be granted an increase to its annual operating revenues from rates of \$10,854. The rates contained in Attachment C will achieve Staff's recommended level of revenue from rates of \$72,805.¹

AMENDED SURCHARGE

The Natural Resources and Environmental Protection Cabinet directed River Bluffs to make several capital improvements to its treatment system. To fund its capital improvements, River Bluffs obtained a 2-year demand note from the National City Bank with an interest rate of 10.25 percent per annum. River Bluffs' monthly debt payments are based on a 5-year amortization.

Staff originally depreciated the capital improvements over their estimated useful lives and recommended that River Bluffs be granted a monthly surcharge to cover the short-term interest payment. However, River Bluffs argued that the depreciation lives Staff used were too long and would not allow it sufficient cash flow to enable it to repay the principal. The City expressed the

¹	Recommended Revenue Requirement	\$ 72,965
	Less: Non-Operating Income	- 160
	Revenue Requirement from Rates	<u>\$ 72,805</u>

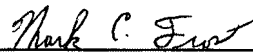
opposite view, that the depreciation lives were too short and the surcharge would allow River Bluffs to over-collect.

To address the problems raised by the City and River Bluffs, Staff has eliminated depreciation of the capital improvements from test-period operations and has modified the recommended surcharge to include the monthly short-term interest and principal payments. The calculation of River Bluffs' monthly surcharge is contained in Attachment C. Staff recommends that River Bluffs' monthly surcharge be in effect for a 60-month period or until the National City Bank loan is retired, whichever is shorter.

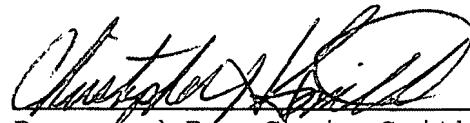
If the surcharge is granted, the proceeds should be placed in a separate interest bearing account. Monthly transfers to the surcharge account should be equal to the proceeds of the monthly surcharge recommended herein and should be transferred from River Bluffs' gross operating revenue prior to the revenue being dispersed for another purpose. River Bluffs should be directed to file with its Annual Report, an annual summary containing the following information: monthly surcharge billings and collections; the monthly bank statement; and loan payments from the account. River Bluffs' failure to comply with the above funding requirements or to file the annual summary should warrant the revocation of the surcharge and refunding of the monies already collected, plus interest thereon.

The surcharge constitutes contributions, and should be accounted for in the manner prescribed by the Uniform System of Accounts for Class C Sewer Utilities. The monthly billing should be debited to customer accounts receivable and credited to the contributions account. When the amount is collected, special funds would be debited and customer accounts credited.

Signatures



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ATTACHMENT A
 AMENDED STAFF REPORT CASE NO. 95-365
 STAFF'S AMENDED PRO FORMA OPERATIONS

	Staff's Pro Forma Operations	Pro Forma Adjustments	Foot- Note Ref	Staff's Pro Forma Operations
Operating Revenue:				
Residential - Flat Rate	\$61,951	\$0		\$61,951
Operating Expenses:				
Owner/Manager Fee	\$3,600	\$0		\$3,600
Sludge Hauling	9,336	2,334	A	11,670
Utility Service - Water	164	0		164
Fuel & Power	7,746	0		7,746
Chemicals	1,342	162	B	1,504
Routine Maintenance Fee	7,380	0		7,380
Maint. Collection System	574	0		574
Maint. Pumping System	702	0		702
Maint. Treatment & Disposal System	2,228	0		2,228
Maint. Other Plant - KPDES Testing	8,320	0		8,320
Agency Collection Fee	1,892	0		1,892
Administrative & General Salaries	1,800	0		1,800
Office Supplies & Other Exp.	835	0		835
Outside Services	1,497	0		1,497
Insurance	2,597	0		2,597
Miscellaneous General Exp.	2,553	0		2,553
Office Rent	3,000	0		3,000
Depreciation	9,562	(5,212)	C	4,350
Amortization	2,262	(1,276)	D	986
Taxes Other Than Income Taxes	811	0		811
Income Taxes	0	0		0
Total Operating Expenses	\$68,201	(\$3,992)		\$64,209
Net Operating Income	(\$6,250)	\$3,992		(\$2,258)
Other Income:				
Interest Income	160	0		160
Miscellaneous Nonoperating Income	0	0		0
Other Deductions:				
Interest Expense	4,563	0		4,563
Net Income	(\$10,653)	\$3,992		(\$6,661)

A. Sludge Hauling:

River Bluffs originally estimated that it would haul 2 loads of sludge every month; however, it is actually hauling 5 loads of sludge every 2 months. Based on its review of River Bluffs' documentation, Staff is of the opinion that it is reasonable to expect that 30 loads of sludge will be hauled on an annual recurring basis. Therefore, this level of loads is reflected in the amended adjustments.

30 (Number of Loads) x \$389 (Cost per 5,000 Gallon Load) =	\$11,670
Staff's Recommended Sludge Hauling Expense	9,336

Staff's Amended Adjustment	\$2,334

B. Chemicals:

River Bluffs operated its dechlorinator for approximately 7 months and during this period used 3 cylinders of sulphur dioxide. Based on this period of actual usage, Staff determined that River Bluffs will use approximately 7 cylinders of sulphur dioxide per year. Therefore, chemical expense has been adjusted to reflect that level of usage.

9 (Number of Cylinders) x \$114 (Cost per Cylinder) =	\$1,026
Less: Staff's Recommended Chemical Expense Adjustment	864

Staff's Amended Adjustment	\$162

C. Depreciation:

River Bluffs made several capital improvements to its treatment system during and after the test period. These improvements were funded with a 2 year demand loan from National City. Since Staff has recommended River Bluffs be granted a monthly surcharge to cover the principal and interest payments, including depreciation would allow River Bluffs double recovery of this investment. Therefore, depreciation associated with these improvements has been removed from test-period operations.

Staff's Recommended Adjustment	(\$5,212)

D. Amortization:

As with depreciation expense, amortization expense has been reduced to eliminate double recovery of the costs funded by the National City loan. Also, River Bluffs incurred legal and accounting fees as a result of the informal conference. Since these costs are nonrecurring they should be amortized over an appropriate period. Therefore, amortization expense has been adjusted to reflect amortizing these fees over a 3-year period.

Amortization of Capital Expenditures		(\$2,070)
Rate Case Expense	\$2,382 / 3 Years =	794

Staff's Recommended Adjustment		(\$1,276)

ATTACHMENT B
AMENDED STAFF REPORT CASE NO. 95-365
REVENUE REQUIREMENT DETERMINATION

Staff's Amended Revenue Requirement:

Amended Operating Expenses	\$64,209
Divided by: Recommended Operating Ratio	88%

Amended Revenue Requirement	\$72,965
Less: Normalized Operating Revenue	61,951
Non-Operating Revenue	160

Amended Revenue Increase	\$10,854

Staff originally included an allowance for income taxes in its revenue requirement determination. The City argued that River Bluffs' improper use of funds resulted in the need to obtain a loan to fund the capital improvements and contributed to the accumulation of the federal income tax loss-carry forward of \$26,603. According to the City, River Bluffs will be able to use its loss-carry forward to avoid the payment of \$2,000 of income taxes over the next 3 years. To ensure that the ratepayers benefited from the loss-carry forward, the City requested that the \$2,000 of avoided income taxes be used to reduce the monthly surcharge over the same 3 year period. The City is correct that River Bluffs improperly used its funds over the years, which is evidenced by the utility's payment of its owner's personal insurance costs. For this reason Staff is of the opinion that the federal income tax loss-carry forward should be considered in determining River Bluffs' revenue requirement, and has therefore eliminated the income tax gross-up from the revenue requirement calculation.

ATTACHMENT C
 AMENDED STAFF REPORT CASE NO. 95-365
 CALCULATION OF AMENDED MONTHLY RATE & SURCHARGE

Staff's Amended Monthly Rate:

Amended Revenue Requirement	\$72,965
Less: Non-Operating Income	160
	\$72,805
Revenue Requirement from Rates	\$72,805
Divided by: 12 Months	12
	\$6,067.08
Monthly Revenue from Rates	\$6,067.08
Divided by: End-of-period Customer Level	166.00
	\$36.55
Staff's Amended Monthly Rates	\$36.55
 <u>Staff's Amended Monthly Surcharge:</u>	
Amount of Loan:	\$48,000
Annual Interest Rate:	10.25%
Term - Years:	5.00
Monthly Principal & Interest Payment	\$1,025.77
Divided by: End-of-period Customer Level	166
	\$6.18
Staff's Amended Monthly Surcharge	\$6.18

Rate Comparison:

	River Bluff's Proposed Rate	Staff's Proposed Rate	Staff's Amended Rate
Monthly Flat Rate	\$47.00	\$39.98	\$36.55
Monthly Debt Surcharge	0.00	2.29	6.18
Average Monthly Bills	\$47.00	\$42.27	\$42.73
Present Tariffed Monthly Rate	31.10	31.10	31.10
Increase in Average Monthly Bill	\$15.90	\$11.17	\$11.63
Percentage Increase	51.13%	35.92%	37.40%

ATTACHMENT D
 AMENDED STAFF REPORT CASE NO. 95-365
 CASH FLOW ANALYSIS

	Staff's Recommended Operations	Staff's Amended Adjustments	Staff's Amended Operations
Operating Revenues	\$61,951	\$0	\$61,951
Add: Revenue Increase	17,487	(6,633)	10,854
Adjusted Operating Revenues	\$79,438	(\$6,633)	\$72,805
Less: Operating Expenses	68,201	(3,992)	64,209
Net Operating Income	\$11,237	(\$2,641)	\$8,596
Add: Interest Income	160	0	0
Surcharge Receipts	4,563	7,746	12,309
Depreciation Expense	9,562	(5,212)	4,350
Amortization	2,262	(1,276)	986
Subtotal	\$27,784	(\$1,383)	\$26,241
Less: Principal & Interest Payment	12,309	0	12,309
Net Cash Flow	\$15,475	(\$1,383)	\$13,932