

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF CROSS CREEK )  
SANITARY, INC. FOR A RATE ADJUSTMENT )  
PURSUANT TO THE ALTERNATIVE RATE ) CASE NO. 97-007  
FILING PROCEDURE FOR SMALL UTILITIES )

O R D E R

On January 7, 1997, Cross Creek Sanitary, Inc. ("Cross Creek") filed its application for Commission approval of proposed sewer rates. Commission Staff, having performed a limited financial review of Cross Creek'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 10 days from the date of this Order.

IT IS THEREFORE ORDERED that all parties shall have no more than 10 days from the date of this Order, or 90 days after the date the application was filed, whichever is later, 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 15th day of May, 1997.

ATTEST:

  
\_\_\_\_\_  
Executive Director

PUBLIC SERVICE COMMISSION

  
\_\_\_\_\_  
For the Commission

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF CROSS CREEK SANITARY, )  
INC. FOR A RATE ADJUSTMENT PURSUANT TO )  
THE ALTERNATIVE RATE FILING PROCEDURE ) CASE NO. 97-007  
FOR SMALL UTILITIES )

STAFF REPORT

Prepared By: Carl Salyer Combs  
Public Utility Financial  
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Communications, Water and  
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Rates and Research Division

STAFF REPORT

ON

CASE NO. 97-007

A. Preface

On January 7, 1997, Cross Creek Sanitary, Inc. ("Cross Creek") filed an application with the Commission seeking to increase its sewer rate pursuant to the Alternative Rate Adjustment Procedure for Small Utilities. The proposed rate would generate approximately \$7,133 annually in additional revenues, an increase of 56.85 percent over normalized test-year revenues of \$12,548.

In order to evaluate the requested increase, the Commission Staff ("Staff") chose to perform a limited financial review of Cross Creek's operations for the test period, calendar year 1995. Since Cross Creek requested and received Staff assistance in preparing this application, the field review was done prior to the filing of the application. Carl Salyer Combs conducted the review on November 27, 1996, at the office of Charles Patton, Cross Creek's treasurer. Mr. Combs is responsible for this Staff Report except for the sections on operating revenues and rate design which were prepared by Christopher H. Smith of the Commission's Division of Rates and Research.

During the course of the review, Cross Creek was informed that all proposed adjustments to test-year expenses must be supported by some form of documentation, such as an invoice, or that all such adjustments must be known and measurable. Based upon the findings of this report, Staff recommends that Cross Creek be authorized to increase its annual operating revenues by \$874.

Scope

The scope of the review was limited to obtaining information to determine whether reported test-period operating revenues and expenses were representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

B. Analysis of Operating Revenues and Expenses

Operating Revenues

In its application, Cross Creek reported 53 customers as of the time the application was filed. A calculation of its test period revenue from rates based on its current number of customers yields a normalized revenue figure of \$12,548 (53 customers X \$19.73 X 12 months). Cross Creek reported miscellaneous revenues of \$2,000. However, this amount represents hookup fees that should have been capitalized and shown as contributions. Therefore, the \$2,000 has been deducted from revenues.

Operating Expenses

Cross Creek incurred, and the Staff-assisted application included, test-period operating expenses of \$13,565. Cross Creek proposed to increase that amount by \$3,400. Cross Creek's proposed adjustments and Staff's recommendations are discussed in the following sections:

Management Fee

Cross Creek reported no test-period management fee. However, Mr. Patton receives \$75 per month (or \$900 annually) to manage the utility. The Commission's normal practice in cases involving small sewer utilities is to allow an annual management fee. The

management duties of Cross Creek's treasurer are comparable to the general oversight responsibilities of a water district commissioner. According to KRS 74.020 (6), a water district commissioner shall receive annual compensation of not more than \$3,600. When informed that such compensation has been allowed by the Commission in previous cases, Cross Creek elected to request an annual management fee of \$900. Therefore, Staff has included an annual management fee of \$900 for rate-making purposes.

#### Sludge Hauling Expense

Cross Creek reported no test-period sludge hauling expense. Staff's review of invoices from Appalachian Waste Control ("Appalachian") for provision of maintenance services revealed that charges of \$1,680 were for hauling 21 loads of sludge at \$80 per load. According to Keith Fairchild of Appalachian, the Cross Creek plant is serving more customers than the number for which it was designed (50), so 21 loads of sludge is not an unreasonable amount on an annual basis. Mr. Fairchild also stated that the truck that carried the 21 loads of sludge had a tank capacity of 1,000 gallons, whereas, the truck currently being used has a 2000-gallon tank. Larry Updike, the Commission's sewer plant inspector, is of the opinion that 12 loads of sludge hauled by a 2000-gallon truck is a reasonable amount annually. According to Mr. Fairchild, the cost of hauling a 2000-gallon load of sludge would be approximately \$140. Therefore, Staff has included annual sludge hauling expense of \$1,680 for rate-making purposes.

#### Electric Expense

Cross Creek proposed to increase reported test-period electric expense of \$932 by \$834 based upon its assertion that the reported amount represented usage for only a

portion of the test year. Staff's review of invoices from Kentucky Power showed total electric expense of \$1,766. Therefore, Cross Creek has supported that level of annual electric expense, and Staff recommends inclusion of annual electric expense of \$1,766 for rate-making purposes.

#### Chemicals Expense

Cross Creek reported no test-period chemicals expense. Staff's review of invoices from Appalachian revealed monthly charges of \$306 for chemicals expense. As mentioned previously in the section on sludge hauling expense, the treatment plant is serving more customers than the number for which it was sized. Mr. Updike of Staff's Engineering Division is of the opinion that the annual chemicals expense is reasonable. Therefore, Staff has included annual chemicals expense of \$3,672 for rate-making purposes.

#### Routine Maintenance Fees

Cross Creek reported no test-period routine maintenance expense. Staff's review of invoices from Appalachian showed a monthly charge of \$130 for such services. Staff therefore recommends inclusion of annual routine maintenance fees of \$1,560 for rate-making purposes.

#### Maintenance of Treatment and Disposal Plant

Cross Creek reported test-period maintenance of treatment and disposal plant expense of \$4,821. However, this amount did not represent charges for the entire test period and it included sludge hauling, chemicals, and routine maintenance expenses. Since those expenses have been reclassified to the appropriate accounts as explained in previous sections, nothing remains in this account. Staff recommends, however, that \$303

reported in maintenance of general plant be reclassified to this account. Therefore, Staff has included annual maintenance of treatment and disposal plant expense of \$303 for rate-making purposes.

#### Outside Services Employed

Cross Creek reported test-period outside services expense of \$674. At the time of the field review, Staff learned that charges of \$565 from Beckman Environmental ("Beckman") were for non-recurring consulting fees. Staff recommends that this amount be excluded from this account for rate-making purposes and that it be amortized over an appropriate period. The remaining \$109 is composed of testing expense of \$47 and \$62 for an item of used equipment from Beckman. Staff is of the opinion that this amount (\$62) is immaterial and that it was proper not to have capitalized and depreciated the item of used equipment. Therefore, Staff has included \$109 as annual outside services expense for rate-making purposes.

#### Regulatory Commission Expense

Cross Creek reported test-period regulatory commission expense of \$100. Staff discovered that this amount represented payment of the minimum Commission assessment of \$50 for both the test year and a previous year. Staff recommends that the \$50 payment for a previous period be excluded and that the \$50 payment for the test period be reclassified to the taxes other than income taxes account, for rate-making purposes. Therefore, no annual regulatory commission expense has been included for rate-making purposes.

Miscellaneous General Expense

Cross Creek reported test-period miscellaneous general expense of \$303. Of that amount, \$200 was paid to the Scott Preston law office for incorporation fees. As this is a non-recurring expense, Staff recommends that it be excluded from this account for rate-making purposes and amortized over an appropriate period. Therefore, Staff recommends inclusion of annual miscellaneous general expense of \$103 for rate-making purposes.

Maintenance of General Plant

Cross Creek reported test-period maintenance of general plant expense of \$303. As mentioned previously, this amount has been reclassified to the maintenance of treatment and disposal plant account. Therefore, no annual maintenance of general plant expense has been included for rate-making purposes.

Depreciation Expense

During the test period, Staffordsville Sanitary Systems, Inc. ("Staffordsville"), in a transaction approved by the Commission in Case No. 95-206,<sup>1</sup> transferred its sewage treatment facilities to Cross Creek. Cross Creek paid nothing for these facilities. The last annual report filed by Staffordsville was for 1992 and showed year-end gross utility plant of \$103,736, accumulated depreciation of \$19,020, and \$-0- in the contributions in aid of construction ("contributions") account. Since Cross Creek had no assets prior to the transfer, its 1995 annual report showed no gross plant amount at the beginning of 1995.

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1 Case No. 95-206, The Application of Cross Creek Sanitary, Inc. for Authority to Assume Operation and Management of the Sewage Treatment Plant Located at the Cross Creek Subdivision, Staffordsville, Johnson County, Kentucky Currently Managed by Staffordsville Sanitary Systems, Inc.



Following the transfer, Cross Creek showed an end-of-year gross plant balance of \$105,086, an increase of \$1,350 over that shown on Staffordsville's 1992 annual report, \$28,562 in accumulated depreciation and \$80,372 in contributions.

Cross Creek reported test-period depreciation expense of \$5,198. However, since Cross Creek paid nothing for the facilities, there is no basis for inclusion of depreciation expense for rate-making purposes, with the exception of the \$1,350 which Cross Creek paid to Baker Fence Company in October, 1995, for fence materials and labor.

The \$1,350 was not shown on Cross Creek's 1995 operating statement, but represents the aforementioned increase shown on the balance sheet. After consulting the Commission's Engineering Division, Staff recommends that the cost of the fence materials and labor be capitalized and depreciated over 10 ten years, for rate-making purposes. Therefore, Staff recommends inclusion of annual depreciation expense of \$135 for rate-making purposes.

The gross plant and contributions balances should also be increased by \$2,000 to record the hookup fees that had been erroneously recorded as revenues. Since these fees represent customer contributions to the system, this adjustment has no impact on the utility's depreciation expense.

#### Amortization Expense

Cross Creek reported no test-period amortization expense. As mentioned in previous sections of this report, Staff recommends amortization of the following non-recurring expenses: (1) the cost of incorporation - \$200; and (2) the cost of consulting fees - \$565. Staff is of the opinion that these expenses should be amortized over a three-year

period for rate-making purposes. Therefore, annual amortization expense of \$255 has been included for rate-making purposes.

#### Taxes Other Than Income Taxes Expense

Cross Creek reported test-period taxes other than income taxes expense of \$557. As explained in the previous section on regulatory commission expense, Staff recommended that the \$50 payment for the test-period utility assessment be reclassified to this account. Subsequent to the filing of this case, Staff discovered that the \$557 represented payments for property taxes for periods prior to the test period. Staff recommends exclusion of this amount for rate-making purposes. According to the Property Valuation Administrator for Johnson County, Kentucky, property tax on Cross Creek's treatment plant will run \$383 annually. Therefore, Staff recommends inclusion of annual taxes other than income taxes expense of \$433 (\$383 + \$50) for rate-making purposes.

#### Operations Summary

Based on the recommendations of Staff contained in this report, Cross Creek's operating statement would appear as shown in Attachment 1.

#### C. Revenue Requirements Determination

The approach frequently used by the Commission to determine revenue requirements for small, privately-owned utilities is the calculation of an operating ratio.<sup>1</sup> This approach is used primarily when there is no basis for a rate-of-return determination or due to the fact that the cost of the utility plant has been recovered fully, or largely,

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<sup>1</sup> Operating Ratio = Operating Expense/Operating Revenue

through the receipt of contributions, either in the form of grants or donated property. As Cross Creek fits this description, Staff recommends use of an operating ratio for determining revenue requirements. The ratio generally used by the Commission in order to provide for equity growth is 88 percent. For utilities subject to federal and state income taxes, an additional allowance is provided to cover those obligations. In this instance, use of an 88 percent operating ratio applied to the adjusted test-period operating expense results in a total revenue requirement of \$13,511.<sup>2</sup> Due to the fact that Cross Creek had test-period other income of \$89, the resulting required revenue from rates would be

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<sup>2</sup> Adjusted Operating Expense/Operating Ratio	\$ 11,593/.88
Required Operating Revenue Exclusive of Provision for Income Taxes	\$ 13,174
Required Operating Revenue without Tax Provision	\$ 13,174
Less: Adjusted Operating Expense	<u>(11,593)</u>
Net Operating Income Exclusive of Provision for Income Taxes	\$ 1,581
Net Operating Income Exclusive of Provision for Income Taxes/Complement of Composite Tax Rate	\$ 1,581/.8245
Net Operating Income Inclusive of Provision for Income Taxes	\$ 1,918
Adjusted Operating Expense	\$ 11,593
Add: Net Operating Income with Income Tax Provision	<u>1,918</u>
Total Revenue Requirement Inclusive of Income Tax Provision	<u>\$ 13,511</u>

\$13,422 (\$13,511 - \$89) and the increase required from rates would be \$874 (\$13,422 - \$12,548 [adjusted test-year revenues]). Therefore, Staff recommends an increase of \$874 in annual revenues from rates.

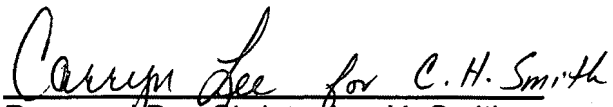
D. Rate Design

In its application, Cross Creek filed a schedule of present and proposed rates. Staff is of the opinion that the present flat rate is reasonable. Cross Creek did not propose to change its present rate design, therefore, any change in revenue in this case will be added to or subtracted from the existing rate structure. The rate set out in Appendix A will produce \$13,422.

E. Signatures



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Water and Sewer Revenue  
Requirements Branch  
Financial Analysis Division



Prepared By: Christopher H. Smith  
Public Utility Rate Analyst  
Communications, Water and  
Sewer Rate Design Branch  
Rates and Research Division

ATTACHMENT 1  
TO STAFF REPORT IN CASE NO. 97-007

	<u>Test Period</u> <u>Application</u>	<u>Recommended</u> <u>Adjustments</u>	<u>Test Year</u> <u>Adjusted</u>
<b>Revenues:</b>			
Flat-Rate	\$ 6,423	\$ 6,125	\$ 12,548
Misc. Revs.	<u>2,000</u>	( <u>2,000</u> )	<u>-0-</u>
Total Rev.	\$ 8,423	\$ 4,125	\$ 12,548
<b>Expenses:</b>			
Mgmt. Fee	\$ -0-	\$ 900	\$ 900
Sludge Hauling	-0-	1,680	1,680
Electric Power	932	834	1,766
Chemicals	-0-	3,672	3,672
Misc. Supplies	49	-0-	49
Routine Maint.	-0-	1,560	1,560
Maint. of Treat- ment Plant	4,821	( 4,518)	303
Outside Services	674	( 565)	109
Insurance	628	-0-	628
Reg. Comm. Exp.	100	( 100)	-0-
Misc. General	303	( 200)	103
Maint. - Gen. Plant	303	( 303)	-0-
Depreciation	5,198	( 5,063)	135
Amortization	-0-	255	255
Taxes Other Than Income Taxes	<u>557</u>	( <u>124</u> )	<u>433</u>
Total Expense	\$ <u>13,565</u>	\$( <u>1,972</u> )	\$ <u>11,593</u>
Net Oper. Income	\$( 5,142)	\$ 6,097	\$ 955
<b>Other Inc./Ded.:</b>			
Interest/Div.	\$ 89	\$ -0-	\$ 89
Net Income	\$ <u>( 5,053)</u>	\$ <u>6,097</u>	\$ <u>1,044</u>

APPENDIX A  
TO STAFF REPORT CASE NO. 97-007  
CROSS CREEK SANITARY, INC.

The following rate is recommended for the customers served by Cross Creek  
Sanitary, Inc.

Monthly Rate:

\$ 21.11