

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF COVERED BRIDGE	)	
UTILITIES, INC. FOR A RATE ADJUSTMENT	)	CASE NO. 97-455
PURSUANT TO THE ALTERNATIVE RATE	)	
FILING PROCEDURE FOR SMALL UTILITIES	)	

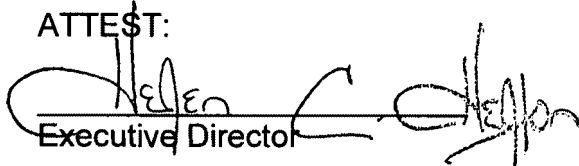
O R D E R

On December 10, 1997, Covered Bridge Utilities, Inc. ("Covered Bridge") filed its application for Commission approval of proposed sewer rates. Commission Staff, having performed a limited financial review of Covered Bridge'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 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 26th day of June, 1998.

ATTEST:

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

PUBLIC SERVICE COMMISSION

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

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STAFF REPORT

Prepared by: Jack Scott Lawless, CPA  
Auditor, Financial Audits Branch  
Division of Financial Analysis

Prepared by: Renee Curry  
Public Utility Rate Analyst  
Communications, Water and Sewer  
Rate Design Branch  
Division of Financial Analysis

STAFF REPORT  
ON  
COVERED BRIDGE UTILITIES, INC.  
CASE NO. 97-455

On December 10, 1997 Covered Bridge Utilities, Inc. ("Covered Bridge") filed its application seeking to increase its rates pursuant to 807 KAR 5:076. In order to evaluate the requested increase, Commission Staff ("Staff") performed a limited financial review of Covered Bridge's test period operations, the year ending December 31, 1996.

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

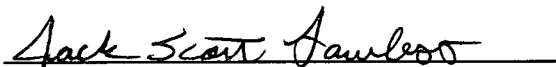
Scott Lawless of the Commission's Financial Audit Branch began the limited review on April 22, 1998. Mr. Lawless is responsible for the preparation of this Staff Report except for the determination of normalized operating revenue and Attachment D, which were prepared by Renee Curry of the Commission's Communication, Water, and Sewer Rate Design Branch.

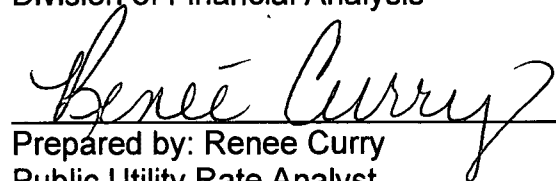
A comparison of Covered Bridge's actual and pro forma operations is shown in Attachment A. Based on Staff's recommendations, Covered Bridge's operating statement would appear as set forth in Attachment B.

Attachment C compares Covered Bridge's and Staff's revenue requirement calculations. Covered Bridge determined its pro forma revenue requirement to be \$87,552.27, an increase in revenues of \$68,382.27. Staff recommends a revenue

requirement of \$58,252.33 or a \$37,024.33 increase. The rates contained in Attachment D will achieve Staff's recommended level of revenue.

Signatures

  
Prepared by: Jack Scott Lawless, CPA  
Auditor, Financial Audits Branch  
Division of Financial Analysis

  
Prepared by: Renee Curry  
Public Utility Rate Analyst  
Communications, Water and Sewer  
Rate Design Branch  
Division of Financial Analysis

ATTACHMENT A  
STAFF REPORT CASE NO. 97-455  
COVERED BRIDGE'S REQUESTED OPERATIONS

	Test Year	Adjustments	Pro Forma Operations
Operating Revenues	\$ 19,170.00		\$ 19,170.00
Operation and Maintenance Expenses			
Management Fee	14,000.00	(10,400.00)	3,600.00
Sludge Hauling	4,021.00	526.00	4,547.00
Utility Service - Water Cost	4,420.00	4,580.00	9,000.00
Other - Labor	8,965.00	395.00	9,360.00
Fuel and Power	5,132.00		5,132.00
Chemicals	2,005.00		2,005.00
Routine Maintenance Fee	5,400.00	600.00	6,000.00
Maintenance of Collection System		2,000.00	2,000.00
Maintenance of Treatment Plant	11,639.00		11,639.00
Maintenance of Other Facilities	1,040.00		1,040.00
Agency Collection Fee	668.00		668.00
Office Supplies		1,800.00	1,800.00
Outside Services Employed	14,885.00	(8,885.00)	6,000.00
Insurance Expense	3,365.00		3,365.00
Regulatory Commission Expense	500.00		500.00
Transportation Expenses	2,300.00		2,300.00
Miscellaneous Expenses	974.00		974.00
Rents	750.00	1,050.00	1,800.00
Total Operation and Maintenance	80,064.00	(8,334.00)	71,730.00
Depreciation	983.00	1,320.00	2,303.00
Amortization		500.00	500.00
Taxes Other Than Income Taxes	113.00		113.00
Income Taxes		2,400.00	2,400.00
Total Operating Expenses	81,160.00	(4,114.00)	77,046.00
Net Operating Income	\$ (61,990.00)	\$ 4,114.00	\$ (57,876.00)

ATTACHMENT B  
STAFF REPORT CASE NO. 97-455  
STAFF'S RECOMMENDED OPERATIONS

	Test Year	Adjustments	Ref	Pro Forma Operations
Operating Revenues	\$ 19,170.00	\$ 2,058.00	a	\$ 21,228.00
Operation and Maintenance Expenses				
Management Fee	14,000.00	(10,400.00)	b	3,600.00
Sludge Hauling	4,021.00	584.41	c	4,605.41
Utility Service - Water Cost	4,420.00		d	4,420.00
Other - Labor	8,965.00	(645.00)	e	8,320.00
Fuel and Power	5,132.00			5,132.00
Chemicals	2,005.00			2,005.00
Routine Maintenance Fee	5,400.00	600.00	f	6,000.00
Maintenance of Collection System			g	
Maintenance of Treatment Plant	11,639.00	(2,126.60)	h	9,512.40
Maintenance of Other Facilities	1,040.00			1,040.00
Agency Collection Fee	668.00			668.00
Office Supplies			i	
Outside Services Employed	14,885.00	(12,397.00)	j	
		315.00	k	2,803.00
Insurance Expense	3,365.00	(2,629.00)	l	736.00
Regulatory Commission Expense	500.00	(500.00)	m	
Transportation Expenses	2,300.00	(2,300.00)	n	
Miscellaneous Expenses	974.00	(974.00)	o	
Rents	750.00	(150.00)	p	600.00
Total Operation and Maintenance	80,064.00	(30,622.19)		49,441.81
Depreciation	983.00	307.24	q	1,290.24
Amortization		417.00	r	417.00
Taxes Other Than Income Taxes	113.00			113.00
Income Taxes			s	
Total Operating Expenses	81,160.00	(29,897.95)		51,262.05
Net Operating Income	\$ (61,990.00)	\$ 31,955.95		\$ (30,034.05)

ATTACHMENT B  
STAFF REPORT CASE NO. 97-455  
STAFF'S RECOMMENDED OPERATIONS

(a) Operating Revenues. Covered Bridge's 1996 annual report indicated that Covered Bridge had 114 customers with annual revenues from rates of \$19,170.00. Covered Bridge currently has 122 customers. With 122 customers, Covered Bridge's annual revenue from rates should be \$21,228.00 (122 customers x \$14.50 per month x 12 months). For the purposes of this report, Covered Bridge's normalized operating revenue will be \$21,228.00.

(b) Owner/Manager Fee. Covered Bridge reported \$14,000.00 for owner/manager fees during 1996. It proposed to reduce this amount by \$10,400.00. Staff agrees with the adjustment and recommends that it be accepted.

(c) Sludge Hauling. Sludge hauling was reported at \$4,021.00 for the test year. Covered Bridge proposed to increase this amount by \$526.00 to reflect monthly sludge hauling. Covered Bridge claimed that monthly sludge hauling was now necessary to properly operate the facility.

Staff reviewed Covered Bridge's sludge hauling records for 1997 to evaluate the reasonableness of this adjustment. Covered Bridge paid \$4,605.41 for sludge hauling throughout 1997. Staff decided to use this amount as the pro forma sludge hauling expense to be recommended. Staff increased test year expenses by \$584.41.

(d) Utility Service - Water Cost. Covered Bridge proposed to increase test year purchased water of \$4,420.00 by \$4,580.00 as a result of installing a gas chlorination and dechlorination system. Through discussion with Martin Cogan, owner of Covered Bridge, Staff determined that these systems were in service throughout the test year and that no adjustment to test year purchased water was necessary. Staff recommends that the requested adjustment be denied.

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STAFF'S RECOMMENDED OPERATIONS

(e) Other - Labor. During the test year Covered Bridge expensed payments to Beckmar Lab that totaled \$8,965.00. \$585.00 was for a sludge analysis while the remainder of \$8,380.00 was for weekly testing fees. Covered Bridge proposed to increase the test year expense by \$395.00 to recover the cost of weekly testing at \$180.00 per week.

Staff determined that weekly testing was required after review of Covered Bridge's KPDES permit. A review of current Beckmar Lab invoices revealed that the cost of a weekly test is \$160.00. Staff calculated the weekly testing adjustment to be a decrease of \$60.00  $((\$160.00 \times 52) - \$8,380.00)$ .

Staff eliminated the \$585.00 sludge analysis fee from this account and included a provision for its recovery over a five year period in the amortization expense account. The net decrease to the other - labor account is \$645.00.

(f) Routine Maintenance Fee. Andriot-Davidson Company ("A-D") performs all the routine maintenance for Covered Bridge. A-D is owned and operated by Martin Cogan and Larry Smither. The contracted routine maintenance fee in effect during the test year was \$450.00 per month or \$5,400.00 annually. A new contract was executed on December 30, 1997, to be effective January 1, 1998, through December 31, 1998. The maintenance fee in the new contract is \$500.00 per month or \$6,000.00 annually. Covered Bridge proposed to increase the test year maintenance fee by \$600.00 as a result of the new contract.

To evaluate the reasonableness of the routine maintenance fee contract, Staff consulted with the Commission's Engineering Division. Staff determined that the



ATTACHMENT B  
STAFF REPORT CASE NO. 97-455  
STAFF'S RECOMMENDED OPERATIONS

adjusted amount was reasonable compensation for the services performed. Staff accepts the proposed adjustment and recommends it be approved.

(g) Maintenance of Collection System. Covered Bridge proposed to increase test year operations by \$2,000.00 for the cost of annual infiltration inspections that were to begin in 1997. Staff found no evidence indicating that such inspection had been performed in 1997. Staff requested supporting documentation as to the cost of such inspection. That information was never provided. Staff recommends that the proposed adjustment be denied. Additionally, it is Staff's opinion that such an inspection is not required on an annual basis. Staff would recommend that all amounts paid for this service be amortized over a period of at least five years.

(h) Maintenance of Treatment Plant. During the test year Covered Bridge expensed \$11,639.00 for maintaining the treatment plant. After reviewing invoices, Staff determined that the following items should be capitalized and depreciated for rate making purposes:

Vendor	Description	Check #	Amount
Quality Electric	Grinder	1472	\$1,339.41
Hesco	New service (labor)	1445	675.00
Highview Hardware	New service (parts)	1441	<u>112.19</u>
Total			<u>\$2,126.60</u>

Staff has eliminated these items from test year operations and provided a provision for their recovery in the depreciation adjustment.

(i) Office Supplies. Covered Bridge increased test year operations by \$1,800.00 to reflect the cost of proposed phone lines at the office of Martin Cogan and the treatment

ATTACHMENT B  
STAFF REPORT CASE NO. 97-455  
STAFF'S RECOMMENDED OPERATIONS

plant facility. Covered Bridge indicated that these lines are necessary to properly service its plant and customers.

Mr. Cogan owns and operates numerous business enterprises located in the same office from which Covered Bridge is headquartered. Covered Bridge has access to a telephone at that location. It is Staff's opinion that an additional phone line is unnecessary. Staff has not included expenses associated with such new service. Staff would not object to a reasonable cost allocation of the existing lines to Covered Bridge; however, no such allocation was prepared by Covered Bridge.

The treatment plant is not manned throughout an entire day. Staff understands the plant is occupied only during routine servicing or non-routine maintenance. Therefore, the treatment plant would not be a reliable location for a customer to contact the utility in case of an emergency.

Covered Bridge contracts out the routine and non-routine maintenance of its treatment plant. They are in daily contact with their contractors via cellular telephone or in person. Therefore, it is not necessary to have a telephone at the treatment plant for Covered Bridge to communicate with its contractors.

Staff recommends that the proposed adjustment be denied.

(j) Outside Services Employed – Bookkeeping. During the test year Covered Bridge paid Martin Cogan \$14,000.00 for bookkeeping services. Covered Bridge proposed to decrease this amount by \$9,800.00 for the annual recovery of \$4,200.00.

Covered Bridge's payments for bookkeeping services represent less than arms length transaction as Mr. Cogan is the owner of Covered Bridge. Therefore, to evaluate the reasonableness of the requested amount, Staff reviewed documentation of fees

ATTACHMENT B  
STAFF REPORT CASE NO. 97-455  
STAFF'S RECOMMENDED OPERATIONS

charged to similar sewer utilities by independent bookkeepers. Staff reviewed bookkeeping fees paid to Linda Wood by six other sewer utilities operated out of the same building as Covered Bridge and whose operations are very similar. Ms. Wood has no affiliation with these utilities except for providing bookkeeping services. Four of those utilities are currently seeking rate increases. During the review of their applications Staff limited pro forma bookkeeping fees to \$1,603.00 per utility. The amount was determined by allocating Linda Wood's annual fee for maintaining all six utilities' books of \$9,620.00 equally to each utility.

Staff recommends that the amount allowed to Covered Bridge for bookkeeping services be limited to \$1,603.00. This amount is the charge of an independent contractor for similar services and represents the fair market value of those services. Staff has decreased test year operations by \$12,397.00 (\$14,000.00-\$1,603.00)

(k) Outside Services Employed – Accounting and Legal. Logsdon and Co. provides accounting services to Covered Bridge that includes the preparation of the Commission's annual report and state and federal tax returns. The fee for 1998 is \$1,200.00. Staff has increased the reported test year expense of \$885.00 by \$315.00.

Covered Bridge proposed to increase test year operations by \$600 for legal fees. Covered Bridge did not report an amount for legal fees during the test year. Staff questioned Martin Cogan about the requested amount. He stated that the amount was not for anything in particular but that it is a conservative estimate of pro forma legal fees. No additional support for the adjustment was presented. Therefore, Staff did not allow the requested adjustment for determining pro forma operating expenses.

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STAFF'S RECOMMENDED OPERATIONS

(l) Insurance Expense. Covered Bridge reported \$3,365.00 for general liability and property insurance. Staff requested a copy of the insurance policy but was not provided with such. Staff was unable to determine the reasonableness of the test year expense. Staff limited Covered Bridge's insurance expense to \$736.00 by decreasing test year expenses by \$2,629.00 (\$3,365.00-\$736.00). Staff determined this amount by reviewing insurance expenses recommended by Staff in rate cases of similar sewer utilities.

(m) Regulatory Commission Expense. Covered Bridge reported regulatory commission expense of \$500.00. This amount represented partial payment of a Division of Water settlement for case no. 18401 94 CI 01481. Staff has eliminated this amount as no penalty or fine should be recovered by a utility through rates.

(n) Transportation. Covered Bridge reported transportation expenses of \$2,300.00. This amount represented mileage reimbursements to Lawrence Smither and Martin Cogan of \$1,300.00 and \$1,000.00, respectively. Staff was not presented any support for these payments. Staff was told that mileage logs were not maintained. Staff eliminated the test year expense due to the lack of supporting evidence.

(o) Miscellaneous. Covered Bridge reported test year miscellaneous expenses of \$974.00. Staff noted that this amount was an accumulation of automatic bank withdrawals. Martin Cogan said that the withdrawals represented bank overdraft charges. Staff has eliminated this expense as it represents a penalty that should be paid by the stockholders of Covered Bridge instead of its customers.

(p) Rents. Covered Bridge proposed to increase test year rent of \$750.00 by \$1,050.00. To determine the reasonableness of this adjustment, Staff requested information regarding the office building occupied by Covered Bridge. The information

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STAFF REPORT CASE NO. 97-455  
STAFF'S RECOMMENDED OPERATIONS

requested included rent paid by nonaffiliated tenants, square footage occupied by those tenants and Covered Bridge, and rent paid by all other companies owned by Martin Cogan operating from that building. Staff never obtained the requested information and was unable to evaluate the reasonableness of the requested adjustment.

Staff chose to limit the rent to be recovered by Covered Bridge to \$600.00 which is the amount paid by other sewer utilities operating from the same office building. Staff decreased test year operations by \$150.00.

(q) Depreciation. Covered Bridge proposed to increase test year depreciation by \$1,320.00 to recover the cost of a computer and fax machine over five years. These items have not been purchased. No support was presented justifying the necessity of such a system or its proposed cost of \$6,600. Staff recommends that the proposed adjustment be disallowed.

Staff adjusted test year depreciation for the items capitalized in the maintenance of treatment plant section of this attachment. Staff consulted with the Commission's Division of Engineering to determine the useful lives.

Item	Cost	Life	Annual Recovery
Grinder	\$1,339.41	5.00	\$267.88
New Service	787.19	20.00	<u>39.36</u>
Total Increase			<u>\$307.24</u>

(r) Amortization. Covered Bridge proposed to amortize rate case expense of \$1,500.00 over 3 years. Staff is of the opinion that rate case expenses should be amortized over the reasonably anticipated life of the rates, which generally will not exceed five years. In light of the fact that Covered Bridge's current rates were approved

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over nineteen years ago, Staff recommends that rate case expenses in this case be amortized over five years.

Staff has amortized the previously mentioned sludge analysis fee of \$585.00 over a five year period. This fee is not an annual expense and its frequency of recurrence is unknown. Therefore, Staff amortized it over the life of the rates to be established in this case.

The net increase for the amortization adjustments is \$417.00  $((\$1,500.00 + \$585.00)/5)$ .

(s) Income Taxes. Covered Bridge proposed to increase test year operations by \$2,400.00 for state and federal income taxes. Staff has disallowed the proposed adjustment as Covered Bridge is currently a Sub-S. The Commission does not allow Sub-S's to recover income taxes through rates as they are the personal responsibility of the stockholders.

ATTACHMENT C  
STAFF REPORT CASE NO. 97-455  
COMPARISON OF REQUESTED AND RECOMMENDED  
REVENUE REQUIREMENTS

	Requested by Covered Bridge	Recommended by Staff
Operating Expenses	\$ 77,046.00	\$ 51,262.05
Divide by: Operating Ratio	<u>0.88</u>	<u>0.88</u>
Required Revenue	87,552.27	58,252.33
Less: Normalized Revenue	<u>(19,170.00)</u>	<u>(21,228.00)</u>
Required Increase	<u>\$ 68,382.27</u>	<u>\$ 37,024.33</u>

ATTACHMENT D  
STAFF REPORT 97-455  
RECOMMENDED SEWER RATES

RECOMMENDED RATES

Single Family Residential

\$39.79 per Month