

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

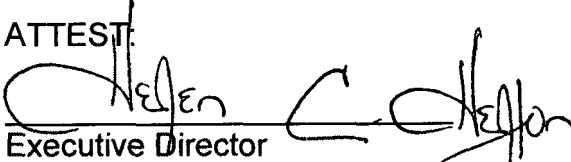
APPLICATION OF WILLOW CREEK SEWER)	
SYSTEM FOR A RATE ADJUSTMENT)	CASE NO. 97-459
PURSUANT TO THE ALTERNATIVE RATE)	
FILING PROCEDURE FOR SMALL UTILITIES)	

ORDER

On December 10, 1997, Willow Creek Sewer System ("Willow Creek") applied for Commission approval of proposed sewer rates. Commission Staff has performed a limited financial review of Willow Creek's operations and prepared the attached Staff Report containing its findings and recommendations regarding the proposed rates. All parties should carefully review the report 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 to request 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 24th day of June, 1998.

ATTEST:

Executive Director

PUBLIC SERVICE COMMISSION

For the Commission

COMMONWEALTH OF KENTUCKY
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PURSUANT TO THE ALTERNATIVE RATE)	
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STAFF REPORT

Prepared by: Beverly B. Davis
Manager, 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
WILLOW CREEK SEWER SYSTEM
CASE NO. 97-459

On December 10, 1997, Willow Creek Sewer System ("Willow Creek") filed an application seeking to increase its rates pursuant to 807 KAR 5:076. To evaluate the requested increase, Commission Staff performed a limited financial review of Willow Creek's test period operations; the year ended 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.

Beverly B. Davis of the Commission's Financial Audits Branch began the limited review on April 22, 1998. Ms. Davis 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 Willow Creek's actual and pro forma operations is shown in Attachment A. Based on Staff's recommendations, Willow Creek's operating statement would appear as set forth in Attachment B.

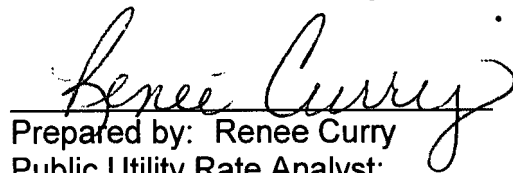
Attachment C compares Willow Creek's and Staff's revenue requirement calculations. Willow Creek determined its pro forma revenue requirement to be \$102,856, an increase in revenues of \$52,664. Staff recommends a revenue

requirement of \$74,820 or a \$22,823 increase. The rates contained in Attachment D will achieve Staff's recommended level of revenue.

Signatures



Prepared by: Beverly B. Davis
Manager, 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. 97-459
WILLOW CREEK'S REQUESTED OPERATIONS

	Test Year	Adjustments	Pro Forma Operations
Operating Revenue			
Flat Rate Revenue	\$ 50,192		\$ 50,192
Operating Expenses			
Management Fee	9,600		9,600
Sludge Hauling	6,182		6,182
Utility Service - Water Cost	2,104	2,246	4,350
Other - Labor	2,565	6,795	9,360
Fuel and Power	11,499		11,499
Chemicals	1,033	1,517	2,550
Routine Maintenance Fee	7,500	2,856	10,356
Maintenance of Collection System	2,249	2,000	4,249
Maintenance of Treatment Plant	8,121		8,121
Maintenance of Other Facilities	2,386		2,386
Agency Collection Fee	2,557		2,557
Office Supplies	31		31
Outside Services Employed	5,079	1,200	6,279
Insurance Expense	980		980
Regulatory Commission Expense	1,840		1,840
Transportation Expense	1,900		1,900
Miscellaneous Expense	161		161
Rents	600		600
Total Operation and Maintenance Expenses	66,387	16,614	83,001
Depreciation	1,157	2,540	3,697
Amortization		500	500
Taxes Other Than Income	767		767
Operating Expenses	68,311	19,654	87,965
Net Operating Income/(Loss)	(18,119)	(19,654)	(37,773)
Other Income and (Deductions)			
Interest Expense	(369)	(2,527)	(2,896)
Net Income/(Loss)	\$ (18,488)	\$ (22,181)	\$ (40,669)

ATTACHMENT B
STAFF REPORT CASE NO. 97-459
STAFF'S RECOMMENDED OPERATIONS

	Test Year	Adjustments	Ref.	Pro Forma Operations
Operating Revenue				
Flat Rate Revenue	\$ 50,192	\$ 1,805	(A)	\$ 51,997
Operating Expenses				
Management Fee	9,600	(6,000)	(B)	3,600
Sludge Hauling	6,182			6,182
Utility Service - Water Cost	2,104	2,246	(C)	4,350
Other - Labor	2,565	5,755	(D)	8,320
Fuel and Power	11,499			11,499
Chemicals	1,033	1,517	(E)	2,550
Routine Maintenance Fee	7,500	-	(F)	7,500
Maintenance of Collection System	2,249	(210)	(G)	2,039
Maintenance of Treatment Plant	8,121	(1,630)	(H)	6,491
Maintenance of Other Facilities	2,386	(1,575)	(I)	811
Agency Collection Fee	2,557			2,557
Office Supplies	31	-		31
Outside Services Employed				-
Bookkeeping	1,950	(347)	(J)	1,603
Accounting Fees	854	346	(J)	1,200
Other	2,275	(2,100)	(J)	175
Insurance Expense	980	(244)	(K)	736
Regulatory Commission Expense	1,840	(1,840)	(L)	-
Transportation Expense	1,900	(1,900)	(M)	-
Miscellaneous Expense	161	(80)	(N)	81
Rents	600			600
Total Operation and Maintenance Expenses	66,387	(6,062)		60,325
Depreciation	1,157	2,908	(O)	4,065
Amortization		685	(P)	685
Taxes Other Than Income	767			767
Operating Expenses	68,311	(2,469)		65,842
Net Operating Income/(Loss)	(18,119)	4,274		(13,845)
Other Income and (Deductions)				
Interest Expense	(369)	369	(Q)	-
Net Income/(Loss)	\$ (18,488)	\$ 4,643		\$ (13,845)

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STAFF'S RECOMMENDED OPERATIONS

- (A) Flat Rate Revenue. Willow Creek's 1996 Annual Report indicated that Willow Creek had 334 customers with annual revenues from rates of \$50,192. Willow Creek's 1997 Annual Report showed Willow Creek had 338 customers. With 338 customers, Willow Creek's annual revenue from rates should be \$51,997 ($338 \times \12.82×12). For the purposes of this report, 1996 normalized operating revenue of Willow Creek will be \$51,997.
- (B) Management Fee. Willow Creek's test year expenses included an owner/management fee of \$9,600. Since the Commission limits this fee to \$3,600 for small investor owned utilities such as Willow Creek; Staff decreased test year operations by \$6,000.
- (C) Utility Service – Water Cost. Willow Creek proposed to increase test year expense to \$4,350 due to the addition of a gas dechlorination unit. Staff evaluated the water expense for four other sewer utilities that have dechlorination units and purchase water from the same source as Willow Creek. The average annual cost for those utilities was \$4,372. Staff agreed with Willow Creek's proposal and increased test year expenses by \$2,246.
- (D) Other – Labor. Test year expenses included \$1,980 for monthly testing and \$585 for a sludge analysis for a total of \$2,565. Willow Creek proposed to increase this account to \$9,360 because its KPDES permit now requires weekly testing of plant effluent. The utility calculated its adjustment based on a weekly testing fee of \$180. Staff reviewed current invoices from the testing laboratory and determined the cost for weekly testing to be \$160. Because the sludge analysis

ATTACHMENT B
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STAFF'S RECOMMENDED OPERATIONS

is not required every year, Staff eliminated the \$585 fee from this account and provided for its recovery in the amortization expense account. Staff increased this account by \$5,755 to allow an annual recovery of \$8,320 ($\$160 \times 52 = \$8,320$).

- (E) Chemicals. The utility proposed to increase this account to \$2,550 due to increased use of chemicals attributable to the addition of the dechlorination unit. Staff examined the chemical expense for four other utilities that have dechlorination units and found the average expense to be \$2,499. Based on this information, Willow Creek's proposal appears reasonable and the adjustment of \$1,517 was accepted.
- (F) Routine Maintenance Fee. Willow Creek proposed to increase test year expense of \$7,500 by \$2,856 to recover an increase in the maintenance fee. The utility attributed the higher fee to the number of daily visits to the plant doubling under the new contract, the increased work required to operate the new dechlorination unit, and inflation. Four sewer utilities owned by Carroll Cogan filed applications for rate increases on the same date. Three of these companies, including Willow Creek, have routine maintenance performed by Andriot-Davidson ("A-D"). Martin Cogan, Carroll Cogan's son, and Larry Smither own A-D. During the test period, two companies had monthly fees of \$625 and one was \$650. The monthly fees proposed in the applications are \$725, \$863, and \$1,015. Despite repeated requests for documentation justifying the wide variance in proposed fees, no information to explain how fees were established was provided. The

ATTACHMENT B
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STAFF'S RECOMMENDED OPERATIONS

Commission's Division of Engineering advised that a monthly maintenance fee of \$625 appears reasonable. Due to the lack of information justifying the reasonableness of the proposed fees, Staff recommends that the monthly maintenance fees be limited to \$625.

- (G) Maintenance of Collection System. Staff reduced test year expense by \$210 for 1995 expenses. Willow Creek proposed an increase of \$2,000 for the cost of an annual inspection for infiltration starting in 1997. No supporting documentation was provided for this item. Additionally, the Commission's Division of Engineering advised that an inspection of this nature would not need to be performed annually. Since no supporting documentation was provided and since this would not be an annual expense, Staff recommends that the proposed increase be denied.
- (H) Maintenance of Treatment Plant. Staff excluded \$1,630 for the cost of fabricating and installing new diffuser drops. This is considered a capital expenditure and provision for its recovery will be made in the depreciation expense account.
- (I) Maintenance of Other Facilities. Staff reduced this account by \$1,575 for capital lease payments for an aerator. This aerator has subsequently been replaced so no provision for its recovery has been made. Provision for recovery of the new aerator has been made in depreciation expense.
- (J) Outside Services Employed.
- Bookkeeping: Test year expenses included \$150 paid to Linda Wood and \$1,800 payable to Mr. Cogan. An increase of \$1,200 for Mr. Cogan's

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STAFF'S RECOMMENDED OPERATIONS

bookkeeping fee was requested in the application. During the staff review, Staff learned that Ms. Wood provided bookkeeping services to all six of Mr. Cogan's sewer utilities for \$185 per week or \$9,620 annually. Staff allocated 1/6th or \$1,603 of Ms. Wood's fee to Willow Creek resulting in an increase of \$1,453 for Ms. Wood's bookkeeping services. Staff eliminated the \$1,800 expense payable to Mr. Cogan and recommends denial of the \$1,200 increase since it could not be determined that he provided any bookkeeping services. He does sign some checks, approves non-routine invoices for payment, maintains some corporate records, and arranges financing; however, these are considered management duties and are compensated by the \$3,600 management fee. The combined effect of these two changes is to reduce test year bookkeeping expense by \$347.

Accounting Fee: Test year expense included \$854 paid to the utility's certified public accountant for preparation of the Commission's annual report and state and federal tax returns. The fee for this service for 1998 will be \$1,200. Staff increased test year expense by \$346 to reflect this change.

Other: Test year operations included \$900 for a \$75 monthly fee paid to Smither Consulting Company for weekly inspections and reports on the condition of the plant and \$175 for completion of an MSD Domestic Treatment Plant Permit application for discharging sludge into the MSD system. The owner of Smither Consulting Company is Larry Smither who also owns fifty percent of A-D, the company that performs the routine maintenance of Willow Creek. The \$900 fee for weekly inspections was eliminated because Staff does not consider it a

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STAFF'S RECOMMENDED OPERATIONS

prudent, necessary expense to pay Mr. Smither through one company to inspect work that another company owned by Mr. Smither is responsible for performing. The test year also included \$1,200 for a monthly fee of \$100 payable to Martin and Assoc. for serving as a liaison between the utility and the Division of Water ("DOW") and for submission of the monthly discharge monitoring reports. Martin Cogan owns Martin and Assoc. It was reported to Staff that Martin and Assoc. does not provide this service to any sewer companies not owned by Carroll Cogan. Dealing with DOW and signing the discharge monitoring reports are part of the management function and are compensated by the management fee. Staff does not consider this a prudent, necessary expense and removed it from test year operations. The total adjustment to this account is a reduction of \$2,100.

- (K) Insurance Expense. Test year expense included \$980 for insurance expense. According to invoices and policies provided by the utility, the cost of a commercial package for all companies owned by Mr. Cogan was \$5,885. The policy covered 8 entities. Staff allocated the cost of the insurance equally to all entities. This results in an insurance expense of \$736 and a decrease to test year operations of \$244.
- (L) Regulatory Commission Expense. This account consists of \$1,340 paid for a KPDES permit and a DOW settlement penalty of \$500. Since the permit has an effective period of 5 years, Staff eliminated the \$1,340 fee from this account and provided for its recovery in the amortization expense account. The Commission

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STAFF'S RECOMMENDED OPERATIONS

does not allow for recovery of penalties so the \$500 penalty was also removed for a total reduction of \$1,840.

- (M) Transportation Expense. Willow Creek's expenses included an allocation of \$1,900 for an automobile lease for Mr. Cogan. No evidence was presented regarding the amount of the lease or the method of allocation. No mileage logs or other documentation of travel was presented to justify this expense. Staff reduced test year operations by \$1,900.
- (N) Miscellaneous Expense. Test year expense included \$80 in bank fees for insufficient funds. The account was reduced for this amount.
- (O) Depreciation Expense. The depreciation adjustment of \$2,908 was computed as follows:

<u>Description</u>	<u>Cost</u>	<u>Life</u>	<u>Expense</u>
Fabrication/installation diffuser drops	\$ 1,603	10 years	\$ 163
Pump	2,463	5 years	493
Comminutor	4,910	5 years	982
Sulfonator	1,823	5 years	365
Sulfonator site preparation	2,507	20 years	125
Aerator	3,900	5 years	780
TOTAL			\$2,908

- (P) Amortization Expense. Willow Creek proposed an adjustment to amortize rate case expense of \$1,500 over 3 years. Rate case expenses should be amortized over the anticipated life of the rates, which usually will not exceed 5 years. Although Willow Creek's current rates were approved 8 years ago, staff recommends that the amortization period be limited to 5 years. Staff also amortized the sludge analysis of \$585 over 5 years and the KPDES permit fee of \$1,340 over 5 years. The total adjustment to this account is \$685.

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- (Q) Interest Expense. Test year expense included \$369 for debt that was paid off in 1997. The application proposed an increase to \$2,896 to permit recovery of interest on a 3 year \$60,000 loan at 9% interest to be used for sewer repair and replacement. According to information provided, over two-thirds of the loan proceeds were used for repayment of loans made to Willow Creek from other Cogan sewer utilities, a loan to another sewer utility, and repayment of the note itself. The loan is a 5-year note with principal and interest amortized over 15 years. The utility did not obtain approval of the loan from the Commission as required by KRS 278.300. Staff recommends that the increase proposed by applicant be denied.

ATTACHMENT C
STAFF REPORT CASE NO. 97-459
COMPARISON OF REQUESTED AND RECOMMENDED
REVENUE REQUIREMENTS

	Requested by Willow Creek	Proposed by Staff
Operating Expenses	\$ 87,965	\$ 65,842
Divide by: Operating Ratio	88%	88%
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Required Revenue from Operating Ratio	99,960	74,820
Add: Interest Expense	2,896	-
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Required Revenue	102,856	74,820
Less: Normalized Revenue	50,192	51,997
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Required Increase	\$ 52,664	\$ 22,823
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ATTACHMENT D
STAFF REPORT CASE NO. 97-459
RECOMMENDED SEWER RATES

RECOMMENDED RATES

Single Family Residential

\$18.45 per Month