

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF THE HERRINGTON)
HAVEN WASTEWATER CO., INC. FOR A)
RATE ADJUSTMENT PURSUANT TO THE) CASE NO. 2000-299
ALTERNATIVE RATE FILING PROCEDURE)
FOR SMALL UTILITIES)

ORDER

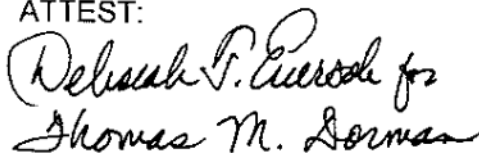
On April 26, 2000, Herrington Haven Wastewater Co., Inc. ("Herrington Haven") filed its application for Commission approval of the proposed sewer rate. Commission Staff ("Staff"), having performed a limited financial review of Herrington Haven's operations, has prepared the attached report containing Staff's findings and recommendations regarding the proposed rate.

IT IS THEREFORE ORDERED that all parties shall, no later than 10 days from the date of this Order, submit written comments, if any, regarding the attached Staff Report or request for hearing or informal conference. If no request for a hearing or informal conference is received by this date, this case shall stand submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this

By the Commission

ATTEST:



Executive Director

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STAFF REPORT

Prepared by: Mark C. Frost
Public Utilities Financial Analyst
Water and Sewer Revenue
Requirements Branch
Division of Financial Analysis

Prepared by: Brent Kirtley
Public Utilities Rate Analyst
Communications, Water and
Sewer Rate Design Branch
Division of Financial Analysis

STAFF REPORT
ON
HERRINGTON HAVEN WASTEWATER CO., INC.
CASE NO. 2000-299

On April 26, 2000, Herrington Haven Wastewater Co., Inc. ("Herrington Haven") 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 Herrington Haven's test-period operations for the 1999 calendar year. Mark C. Frost of the Commission's Division of Financial Analysis performed the limited review on September 15, 2000.

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. Mr. Frost is responsible for the preparation of this Staff Report except for the determination of normalized operating revenue, and the calculation of the recommended rate which were prepared by Brent Kirtley of the Commission's Division of Financial Analysis.

A comparison of Herrington Haven's actual and pro forma operations is shown in Attachment A. Based upon Staff's recommendations, Herrington Haven's operating statement would appear as set forth in Attachment B and Attachment C is Staff's discussions on its proposed pro forma adjustments.

Herrington Haven requests a pro forma revenue requirement of \$11,558, an increase of \$3,650 over normalized test-period revenues of \$7,908. As shown in

Attachment D, Staff's pro forma operations and an 88 percent operating ratio results in a revenue requirement of \$10,221, an increase of \$2,313 above normalized test-period revenues of \$7,908. The calculated in Attachment D will achieve Staff's recommended level of revenue.

Signatures

Prepared by: Mark C. Frost
Public Utilities Financial Analyst
Water and Sewer Revenue
Requirements Branch
Division of Financial Analysis

Prepared by: Brent Kirtley
Public Utilities Rate Analyst
Communications, Water and
Sewer Rate Design Branch
Division of Financial Analysis

ATTACHMENT A
STAFF REPORT CASE NO. 2000-086
HERRINGTON HAVEN'S REQUESTED
PRO FORMA OPERATIONS

	Actual Test Period	Pro Forma Adjustments	Ref.	Pro Forma Operations
Operating Revenues:				
Residential Flat Rate	\$ 7,658	\$ -		\$ 7,658
Operating Expenses:				
Operation & Maintenance Exp:				
Owner/Manager Fee	\$ 3,600	\$ -		\$ 3,600
Sludge Hauling	300	0		300
Chemicals – Chlorine	133	600		733
Fuel & Power	774	0		774
Misc. Supplies & Exp.	280	0		280
Testing Fee	395	1,069		1,464
Uncollectible Accounts	219	0		219
Admin. & Gen. Salaries	600	0		600
Office Supplies	250	0		250
Insurance Expense	350	0		350
Regulatory Commission Exp.	50	0		50
Transportation Expense	510	0		510
Total Operation & Maint. Exp.	\$ 7,461	\$ 1,669		\$ 9,130
Depreciation	0	0		0
Principal & Interest	0	2,234		2,234
Amortization	0	0		0
Taxes Other Than Income Taxes	82	0		82
Total Operating Expenses	\$ 7,543	\$ 3,903		\$ 11,446
Net Operating Income	\$ 115	\$ (3,903)		\$ (3,788)

ATTACHMENT B
STAFF REPORT CASE NO. 2000-086
STAFF'S RECOMMENDED
PRO FORMA OPERATIONS

	Test Period Actual	Pro Forma Adjustments	Ref.	Pro Forma Operations
Operating Revenues:				
Residential Flat Rate	\$ 7,658	\$ 250	(a)	\$ 7,908
Operating Expenses:				
Operation & Maintenance Exp:				
Owner/Manager Fee	\$ 3,600	\$ -		\$ 3,600
Sludge Hauling	300	20	(b)	320
Chemicals – Chlorine	133	76	(c)	209
Fuel & Power	774	0		774
Misc. Supplies & Exp.	280	(280)	(d)	0
Testing Fee	395	93	(e)	488
Uncollectible Accounts	219	28	(f)	247
Admin. & Gen. Salaries	600	0		600
Office Supplies	250	(7)	(g)	243
Insurance Expense	350	0		350
Regulatory Commission Exp.	50	0		50
Transportation Expense	510	0		510
Total Operation & Maint. Exp.	\$ 7,461	\$ (70)		\$ 7,391
Depreciation	0	595	(h)	595
Amortization	0	200	(i)	200
Taxes Other Than Income Taxes	82	0		82
				0
Total Operating Expenses	\$ 7,543	\$ 725		\$ 8,268
Net Operating Income	\$ 115	\$ (475)		\$ (360)
Other Deductions:				
Interest Expense	0	826	(j)	826
Net Income	\$ 115	\$ (1,301)		\$ (1,186)

ATTACHMENT C
STAFF REPORT CASE NO. 2000-299
STAFF'S
PRO FORMA ADJUSTMENTS

(a) Operating Revenues - Residential. In its 1999 Annual Report, Herrington Haven reports annual operating revenues from residential flat rates of \$7,658 and an end-of-period customer level of 24. Multiplying the end-of-period customer level by the current tariffed rate of \$24.70 per month results in a normalized test period operating revenues from residential flat rates of \$7,908, which is \$250 above the test period level. Operating revenues have been increased by \$250 to reflect the normalized revenue level.

(b) Sludge Hauling. Herrington Haven's test period sludge hauling expense of \$300 reflects the removal of 4 loads or 4,400 gallons of sludge. Although, no adjustment to this expense was proposed, Melvin Price, Herrington Haven's owner/operator, informed Staff that to properly operate the treatment facilities the number of sludge loads hauled per year should be increased from 4 to 6, which would result in an adjustment of \$180 to the reported test period level.

Subsequent to the filing of the application, the Commission granted Herrington Haven a Certificate of Public Convenience and Necessity ("Certificate") to install a 9,800-gallon package wastewater treatment plant.¹ The installation of the new treatment plant will directly impact the variable expenses (i.e: sludge hauling, purchased water, and fuel and power). Since, Herrington Haven has not demonstrated how its new

¹ Case No. 2000-407, The Application of Herrington Haven Wastewater Co., Inc. for a Certificate of Public Convenience and Necessity for the Construction of a Package Wastewater Treatment Plant issues October 19, 2000.

ATTACHMENT C
STAFF REPORT CASE NO. 2000-299
STAFF'S
PRO FORMA ADJUSTMENTS

treatment plant will impact its operations, an adjustment to reflect an increase in the number of loads of sludge hauled fails to meet the rate-making criteria of known and measurable. For this reason an adjustment to reflect any increase in the number of sludge loads hauled has not been made.

Multiplying the test period loads of sludge of 4 by the current hauling fee of \$80 per load, results in a actual sludge hauling expense of \$320, which is \$20 above the reported test period level. Accordingly, sludge hauling expense has been increased by that amount.

(c) Chemical & Miscellaneous Supplies. Herrington Haven proposes to increase its test period chemical & miscellaneous supplies expense of \$133 by \$600 to reflect a \$50 monthly increase in chemicals or miscellaneous supplies. In 2000, Herrington Haven installed a new chlorinator that uses 3-inch chlorine tablets. In response to Staff's request, Herrington Haven provided a copy of an invoice showing that the annual cost of chlorine tablets is \$135.

Since the chlorinator has been installed and the cost of the 3-inch tablets has been documented, an adjustment to reflect the increased cost would meet the rate-making criteria of known and measurable. Accordingly, chemical & miscellaneous supplies expense has been increased by \$76² to reflect the increased chlorine cost.

² \$136 (Pro Forma Cost) - \$60 (Actual Cost) = \$76.

ATTACHMENT C
STAFF REPORT CASE NO. 2000-299
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(d) Miscellaneous Supplies and Expense. Upon reviewing the invoices, Staff determined that the test period materials and supplies expense of \$280 represented the cost of a pump. The purchase of a pump is a capital expenditure that should be depreciated rather than expensed. Therefore, the operating expenses have been reduced by \$280 to eliminate this item from the test-period operations. A provision for the recovery of the capital expenditure is included in the depreciation expense adjustment.

(e) Testing Fee. Herrington Haven proposes a pro forma level of testing expense of \$1,464, which is \$1,069 above its test-period level of \$395. This adjustment reflects Herrington Haven's expectation that its new KPDES permit will require the plant effluent to be tested monthly and the current testing fee of \$122 per test.

Subsequent to the filing of the application, Herrington Haven has received its KPDES construction permit, which requires Herrington Haven to continue to test its effluent on a quarterly basis. To reflect the KPDES quarterly testing requirement, the testing fee expense has been increased by \$93.³

(f) Uncollectibles. Herrington Haven reports a test period uncollectible expense of \$219. Upon reviewing the billing records, Staff determined that actual uncollectible

³ \$122 (Fee per Test) x 4 (Tests per Year) =	\$ 488
Less: Reported Test Period Level	- 395
Pro Forma Adjustment	<u>\$ 93</u>

ATTACHMENT C
STAFF REPORT CASE NO. 2000-299
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PRO FORMA ADJUSTMENTS

expense is \$247, which is \$28 above test period level. Accordingly, the uncollectibles expense has been increased by that amount.

(g) Office Supplies. Herrington Haven's test period office supplies expense is \$250. Upon review of the test period invoices, Staff determined that office supplies expense was overstated by \$7, and therefore, has decreased office supplies expense by that amount.

(h) Depreciation. Herrington Haven's test period operating expenses does not include depreciation expense. The Order granting Herrington Haven the Certificate to construct its new treatment plant states that the estimated construction cost is \$7,920, including the KPDES construction permit of \$900 increases the estimated construction cost to \$8,820.

Staff recommends test period operating expenses be increased by \$595 to reflect an allowance for depreciation expense, which was calculated in the following manner:

<u>Description</u>	<u>Cost</u>	<u>Depreciation</u>	
		<u>Lives</u>	<u>Expense</u>
New Treatment Plant	\$ 8,820	20 Years	\$ 441
Chlorinator	\$ 100	5 Years	20
Pump	\$ 252	5 Years	50
Blower	\$ 836	10 Years	+ 84
Pro Forma Depreciation			<u>\$ 595</u>

(i) Amortization. Once its new treatment plant is operational, Herrington Haven will be required to obtain a new KPDES discharge permit. Herrington Haven provided a copy of a canceled check to show that a new KPDES permit will cost \$1,000. Staff has

ATTACHMENT C
STAFF REPORT CASE NO. 2000-299
STAFF'S
PRO FORMA ADJUSTMENTS

calculated amortization expense of \$200, which reflects amortizing the cost of KPDES permit over 5 years. Accordingly, test period operating expenses have been increased by \$200.

(j) Interest Expense. To finance the treatment plant construction, Herrington Haven obtained a loan from Bank One in the amount of \$8,075. The Bank One loan has an interest rate of 13.4 percent per annum and a 5-year term.

At the August 18, 2000, Informal Conference, Herrington Haven was informed that KRS 278.300 requires Commission approval of financing unless the financing meets one of the exemptions set forth in the statute. Herrington Haven admitted that it was unaware of the requirements of the statute, but agreed to either restructure the loan to meet the exemption provision of KRS 278.300 or to repay the loan and apply for a new loan to submit for approval by the Commission. However, Bank One has informed Herrington Haven, there will be a significant increase in the interest rate if the existing loan is restructured or if a new loan is issued.

In reviewing financing for approval under KRS 278.300, the Commission determines if the financing is for the lawful objects within the utility's corporate purposes, is necessary and appropriate for and consistent with the proper performance by the utility of its service to the public and will not impair its ability to perform that service. Since Herrington Haven received a Certificate to construct its treatment plant, then it is reasonable to assume that the associated financing would have been approved if Herrington Haven had so requested. Furthermore, the Attorney General

ATTACHMENT C
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STAFF'S
PRO FORMA ADJUSTMENTS

stated at the informal conference that he would have no objection to Herrington Haven renegotiating the financing or to recovery by the utility of the debt already incurred if found that it would have been approved by the Commission.

Given these circumstances, Staff recommends that the interest associated with the Bank One loan be included in Herrington Haven's expenses on a going-forward basis. Since Herrington Haven is now aware of the statutory requirements, Staff further recommends that the Commission give Herrington Haven notice that failure to obtain prior approval of future financing will result in the failure to recover the associated interest in rates.

Staff has included interest expense of \$826 in Herrington Haven's test period operations, which reflects the 3-year average interest on the Bank One loan.

ATTACHMENT D
STAFF REPORT CASE NO. 2000-299
STAFF'S
RECOMMENDED
REVENUE REQUIREMENT & RATES

Operating Expenses	\$ 8,268
Divided by: Operating Ratio	<u>÷ 88%</u>
Subtotal	\$ 9,395
Add: Interest Expense	<u>+ 826</u>
Revenue Requirement	<u>\$ 10,221</u>

Revenue Requirement	\$ 10,221
Less: Normalized Operating Revenue	<u>- 7,908</u>
Recommended Increase	<u>\$ 2,313</u>

Revenue Requirement	\$ 10,221
Divided by 12-Months	<u>÷ 12</u>
Monthly Collections	\$ 851.75
Divided by: Customer Level	<u>÷ 24</u>
Recommended Monthly Rate	<u>\$ 35.49</u>