

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF B & H, INC. FOR A )  
RATE ADJUSTMENT PURSUANT TO THE ) CASE NO.  
ALTERNATIVE RATE FILING PROCEDURE ) 2000-452  
FOR SMALL UTILITIES )

ORDER

On October 23, 2000, B & H, Inc. ("B & H") filed its application for Commission approval of the proposed sewer rate. Commission Staff ("Staff"), having performed a limited financial review of B & H'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 23<sup>rd</sup> day of January, 2001.

By the Commission

ATTEST:

  
Executive Director

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF THE B & H, INC.     )  
FOR A RATE ADJUSTMENT PURSUANT     ) CASE NO.  
TO THE ALTERNATIVE RATE FILING     ) 2000-452  
PROCEDURE FOR SMALL UTILITIES     )

STAFF REPORT

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

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

STAFF REPORT

ON

B & H, INC.

CASE NO. 2000-452

On October 23, 2000, B & H, Inc. ("B & H") 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 B & H'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 November 20 and December 4, 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, Attachment E, and Attachment F, which were prepared by Renee Curry of the Commission's Division of Financial Analysis.

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

Based upon its pro forma operations B & H determined that it could support a revenue requirement of \$81,906. However, the rates requested by B & H produce a revenue requirement of \$69,350, an increase \$17,253 over Staff's normalized test

period revenues of \$52,907, as calculated in Attachment D. As shown in that same attachment, Staff has determined that B & H could justify a revenue requirement of \$76,041, an increase of \$23,944 above normalized test period revenues. However, Staff recommends the Commission accept B & H's proposed rates, which will produce a revenue requirement of \$69,350 and are contained in Attachment E.

If B & H wishes to amend its application to reflect the rates that will generate the revenue requirement of \$76,041 and that are contained in Attachment F, it should file such amendment with any comments on the Staff Report. Should B & H amend its application, Staff recommends the Commission require B & H to notify its ratepayers of the amended rate proposal.

Signatures

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

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

ATTACHMENT A  
STAFF REPORT CASE NO. 2000-299  
B & H'S  
PRO FORMA OPERATIONS

	Actual Test period	Pro Forma Adjustments	Pro Forma Operations
Operating Revenues:			
Residential	\$ 51,384	\$ (382)	\$ 51,002
Operating Expenses:			
Operation & Maintenance Exp:			
Pumping System Expense	\$ 1,374	\$ -	\$ 1,374
Sludge Hauling	42,964	(18,964)	24,000
Utilities	3,808	0	3,808
Sewer Analysis	26	1,678	1,704
Chemicals	6,086	0	6,086
Freight	523	0	523
Routine Maintenance	13,040	0	13,040
Maint - Treatment & Disp.	12,314	(9,314)	3,000
Admin & General	7,420	0	7,420
Office Supplies Exp.	661	0	661
Bank Charges	431	0	431
Legal & Professional	1,066	0	1,066
Civil Penalty	5,000	(5,000)	0
Travel & Schooling	610	(610)	0
Regulatory Commission	359	0	359
Total Operation & Maint. Exp.	\$ 95,682	\$ (32,210)	\$ 63,472
Depreciation	0	0	0
Amortization	0	0	0
Taxes Other Than Income	442	0	442
Total Operating Expenses	\$ 96,124	\$ (32,210)	\$ 63,914
Operating Income	\$ (44,740)	\$ 31,828	\$ (12,912)
Interest Expense	2,207	4,993	7,200
Net Income/(Loss)	\$ (46,947)	\$ 26,835	\$ (20,112)

ATTACHMENT B  
STAFF REPORT CASE NO. 2000-299  
STAFF'S  
PRO FORMA OPERATIONS

	Actual Test period	Pro Forma Adjustments		Pro Forma Operations
Operating Revenues:				
Residential	\$ 51,384	\$ 713	a	\$ 52,097
Operating Expenses:				
Operation & Maintenance Exp:				
Pumping System Expense	\$ 1,374	\$ -		\$ 1,374
Sludge Hauling	42,964	(28,564)	b	14,400
Utilities	3,808	(794)	c	3,014
Sewer Analysis	26	1,678	d	1,704
Chemicals	6,086	(181)	e	5,905
Freight	523	0		523
Routine Maintenance	0	6,600	f	6,600
Maint. – Struct. & Imp.	13,040	(6,036)	g	7,004
Maint - Treatment & Disp.	12,314	(9,476)	h	2,838
Admin & General	7,420	(100)	i	7,320
Office Supplies Exp.	661	0		661
Bank Charges	431	0		431
Legal & Professional	1,066	0		1,066
Civil Penalty	5,000	(5,000)	j	0
Travel & Schooling	610	(610)	k	0
Regulatory Commission	359	0		359
Total Operation & Maint. Exp.	\$ 95,682	\$ (42,483)		\$ 53,199
Depreciation	0	862	l	862
Amortization	0	7,396	m	7,396
Taxes Other Than Income	442	0		442
Total Operating Expenses	\$ 96,124	\$ (34,225)		\$ 61,899
Operating Income	\$ (44,740)	\$ 34,938		\$ (9,802)
Interest Expense	2,207	1,482	n	3,689
Net Income/(Loss)	\$ (46,947)	\$ 33,456		\$ (13,491)

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

(a) Operating Revenues - Residential. B & H proposes to decrease its annual operating revenues from residential flat rates by \$382 to a pro forma level of \$51,002. This adjustment is based on B & H's current tariffed rates and the end-of-period customer levels of 94 multi-family units and 70 single-family units.

Subsequent to the filing of the application, B & H discovered that the number of multi-family units had increased from 94 to 98 units. Using the increased multi-family units of 98 and B & H's current tariffed rates, the normalized test period operating revenues from residential flat rates is \$52,097, which is \$713 above the reported test period level. Accordingly, operating revenues have been increased by \$713 to reflect Staff's normalized revenue level.

(b) Sludge Hauling. B & H proposes to reduce its test period sludge hauling expense of \$42,964 by \$18,964 to a pro forma level of \$24,000. This adjustment reflects B & H's claim that improvements at the treatment plant has resulted in a reduction in the amount of sludge produced.

Epperson Septic Service's ("Epperson") current sludge hauling fee is \$200 per 2,000-gallon load. Dividing B & H's proposed sludge hauling expense of \$24,000 by the \$200 per load fee, results in 120 loads or 240,000 gallons of sludge being removed on an annual basis. Considering the size of B & H's treatment plant, Staff believes that the proposed level of annual sludge removal of 240,000 gallons is excessive.

In responding to Staff's questions regarding the appropriate amount of annual sludge hauling, Ron Bowman, B & H's treatment plant operator stated that the sludge

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

hauling expense should not be budgeted for less than \$15,000. According to Mr. Bowman there is a problem with the filament at the treatment plant, which produces a low "D.O." reading. For this reason, Mr. Bowman claims the sludge does not settle and compact, resulting in an increase in the amount of sludge that should be removed.

Mr. Bowman's statement regarding the condition of the treatment plant seems to contradict B & H's claim regarding the improved condition of the treatment plant made by B & H in its application. Furthermore, in determining the appropriate level of sludge hauling expense, the utility should first determine the amount of sludge that should be removed and then use this information to arrive at the expense level. In this instance B & H determined what it deemed to be an appropriate expense level without contemplating the amount of sludge or the number of loads that it needed to remove on an annual basis.

Because B & H has difficulty operating within the Division of Water ("DOW") discharge requirements, Mr. Bowman claims that at a minimum 6 loads of sludge should be removed on a monthly basis. Removing this level of sludge per month results in 72 loads or 144,000 gallons of sludge on an annual basis at an annual cost of \$14,400. Given the condition of the treatment plant and B & H's inability to operate within the regulatory guidelines, Staff recommends that an allowance for this level of sludge hauling be accepted. Accordingly, sludge hauling expense has been decreased by \$28,564 to reflect removing 72 loads of sludge per year.



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

(c) Utilities. B & H reports a test period level of utilities expense of \$3,808. Upon its review of the electricity and water invoices, Staff determined that the actual test period utilities expense was \$3,014, which is \$794 below B & H's reported level. Therefore, utilities expense has been decreased by that amount.

(d) Sewer Analysis. B & H proposes to increase its test period sewer analysis expense of \$24 by \$1,678 to a pro forma level of \$1,704. According to B & H its treatment plant operator historically paid the sewer analysis fees. Subsequent to the test period, B & H began paying for its tests, which is the basis for this adjustment. Upon its review of the invoices from Commonwealth Technology and EnviroData Group, Staff determined that B & H's proposed adjustment reflects the actual cost to perform the required test, and therefore, B & H's pro forma adjustment is accepted.

(e) Chemicals. B & H reports a test period chemical expense of \$6,086. In reviewing the general ledger and invoices, Staff discovered that in the test period B & H paid Rick Cole \$181 for chemicals. Since, Mr. Cole is no longer a B & H employee, this chemical cost will not be incurred in the future. Accordingly, chemical expense has been decreased by \$181 to eliminate this cost.

(f) Routine Maintenance. At the end of the test period, B & H hired Mr. Bowman as its licensed treatment plant operator. Mr. Bowman provides the routine maintenance services for a fee of \$550 per month. Staff is of the opinion that the fee is reasonable and an adjustment to reflect the routine maintenance fee would meet the rate-making

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

criteria of known and measurable. Therefore, operating expenses has been increased by \$6,600 to reflect Mr. Bowman's fee.

(g) Maintenance of Structures & Improvements. B & H reports a test period level of maintenance of structures & improvements expense of \$13,040. Upon review of the general ledger, Staff determined that B & H misclassified its routine maintenance fees of \$6,036. Ordinarily, the incorrect classification of an operating expense would not affect the overall determination of B & H's revenue requirement. However, Staff included the proper amount of pro forma routine maintenance expense in the correct account. Accordingly, maintenance of structures & improvements expense has been decreased by \$6,036.

(h) Maintenance of Treatment & Disposal Plant. B & H proposes to reduce the maintenance of treatment & disposal plant expense by \$9,314 to a pro forma level of \$3,000. According to B & H, during the test period major plant improvements were made in accordance with an Agreed Order with the DOW. Because the DOW required B & H to perform an infiltration study, several manholes will need to be improved. The pro forma level of maintenance of treatment & disposal plant expense, as proposed by B & H reflects the estimated cost to improve its manholes.

After reviewing the invoices, Staff determined that B & H's plant improvements were \$9,476, which is \$162 above B & H's pro forma adjustment. Because a capital expenditure should be depreciated rather than expensed, the maintenance of treatment

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

& disposal plant expense has been reduced by \$9,476. A provision for the recovery of the capital expenditures is included in the depreciation expense adjustment.

(i) Administrative & General. The test period level of administrative & general expense is \$7,420, which represents the service fees paid to Hager Cabinets, Inc. ("Hager"). In accordance with the service agreement, Hager has agreed to provide office space, utilities, and various administrative services to B & H for fee of \$610 per month. In B & H's previous two rate cases<sup>1</sup> the Commission allowed the monthly contract fee of \$610 for these services. Using the contract fee of \$610 per month, Staff determined that the annual cost is \$7,320, and therefore, administrative & general expense has been reduced by \$100.

(j) Civil Penalty. B & H proposes to decrease its test period operating expenses by \$5,000 to eliminate the civil penalty paid to the DOW. During the test period, B & H was assessed \$5,000 in fines and penalties by the DOW for various violations at the sewage treatment plant. Since, it is the owner/manager's responsibility to insure that the treatment plant is operated and conforms to the appropriate regulatory guidelines, any fine or penalty assessed due to B & H's failure to meet any established guideline should

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<sup>1</sup> Case No. 90-223, The Application of B & H Incorporated for a Rate Adjustment Pursuant to the Alternative rate filing Procedure for Small Utilities, Order issued December 20, 1990.

Case No.93-307, The Application of B & H Incorporated for a Rate Adjustment Pursuant to the Alternative rate filing Procedure for Small Utilities, Order issued March 1, 1994.

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

be borne by the owner/manager and not the ratepayers. Therefore, operating expenses has been decreased by \$5,000 as proposed by B & H.

(k) Travel & Schooling. B & H proposes to reduce its operating expenses by \$610 to eliminate the education reimbursement paid to Mr. Cole. Since Mr. Cole is no longer an employee the payment of the education reimbursement will cease to be an ongoing expense, and therefore, B & H's proposed adjustment is accepted.

(l) Depreciation. B & H's test period operating expenses does not include depreciation expense. Staff increased test period operating expenses by \$862 to reflect depreciating the items capitalized in the maintenance of treatment & disposal plant section of this attachment over their estimated useful lives:

<u>Description</u>	<u>Cost</u>	<u>Useful Lives</u>	<u>Depreciation Expense</u>
Diffusers	\$ 3,875	10 Years	\$ 388
Flow Meter	\$ 3,880	10 Years	388
Culverts	\$ 1,435	20 Years	72
Septic Tank	\$ 286	20 Years	+ 14
Pro Forma			<u>\$ 862</u>

(m) Amortization. In the test period B & H paid \$31,515 to have its lagoon cleaned. As previously mentioned DOW required B & H to perform an infiltration test which was performed subsequent to the test period at a cost of \$3,279. Since these items are non-recurring, their costs should be amortized over an appropriate period. Amortizing the lagoon cleaning over 5-years and the infiltration test over 3-years results in a pro forma level of amortization expense of \$7,396. Accordingly, operating expenses have been increased by that amount.

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

(n) Interest Expense. B & H reports test period interest expense of \$2,207, which it proposes to increase by \$4,993. This adjustment reflects the current interest being paid on B & H's outstanding debt, which has an outstanding balance of \$91,900. The debt was incurred for the purpose of funding current operating expenses and treatment plant improvements.

It has been approximately 7 years since B & H sought and was granted a rate increase. It is the owner/managers responsibility to monitor the financial condition of the utility and to seek rate relief in a timely manner. For this reason Staff believes that the interest associated with the debt incurred to fund the current operating expenses should be borne by the owner/manager and not the ratepayers.

Of the total debt of \$91,900, approximately 44.6 percent or \$40,991 was used to fund capital improvements and lagoon cleaning. According to a document provided by B & H this debt requires interest payments based on the prime interest rate. Based on the January 9, 2001 prime interest rate of 9 percent per annum, B & H's pro forma annual interest expense would be \$3,689, or \$1,482 above the test period level. Therefore, interest expense has been increased by that amount.

ATTACHMENT D  
STAFF REPORT CASE NO. 2000-299  
RECOMMENDED & REQUESTED  
REVENUE REQUIREMENTS

**Revenue Requirement Determination**

	<u>B &amp; H</u>	<u>Staff</u>
Operating Expenses	\$ 63,914	\$ 61,899
Divided by: Operating Ratio	÷ 88%	÷ 88%
Subtotal	\$ 72,360	\$ 70,340
Less: Operating Expenses	- 63,914	- 61,899
Net Operating Income After Income Taxes	\$ 8,716	\$ 8,441
Multiplied by: Gross-Up Factor	x 1.23839	x 1.23839
Net Operating Income Before Income Taxes	\$ 10,794	\$ 10,453
Add: Operating Expenses	63,914	61,899
Interest Expense	+ 7,200	+ 3,689
Revenue Requirement	<u>\$ 81,908</u>	<u>\$ 76,041</u>

**Operating Revenue Increase**

	<u>B &amp; H</u>	<u>Staff</u>
Revenue Requirement	\$ 81,908	\$ 76,041
Less: Normalized Operating Revenue	- 52,097	- 52,097
Recommended Increase	<u>\$ 29,811</u>	<u>\$ 23,944</u>

**Increase from Requested Rates**

70 Single-Family Units @ \$40.00 x 12-Months =	\$ 33,600
98 Multi-Family Units @ \$30.40 x 12-Months =	+ 35,750
Total Operating Revenue	<u>\$ 69,350</u>
Less: Normalized Operating Revenue	- 52,097
Requested Revenue Increase	<u>\$ 17,253</u>

ATTACHMENT E  
STAFF REPORT CASE NO. 2000-299  
B & H's REQUESTED  
RATES

Multi-family Units	\$ 30.40 monthly
Single-family Units	\$ 40.00 monthly

ATTACHMENT F  
STAFF REPORT CASE NO. 2000-299  
RATES B & H COULD  
JUSTIFY

Multi-family Units	\$ 33.28 monthly
Single-family Units	\$ 43.93 monthly