

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF EVERGREEN	)	
SEWAGE DISPOSAL, INC. FOR AN	)	
ADJUSTMENT OF RATES PURSUANT	)	CASE NO.
TO THE ALTERNATIVE RATE FILING	)	2005-00431
PROCEDURE FOR SMALL UTILITIES	)	

O R D E R

On October 19, 2005, Evergreen Sewage Disposal, Inc. ("Evergreen") filed its application for Commission approval of proposed sewer rates. Commission Staff, having performed a limited financial review of Evergreen'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 15<sup>th</sup> day of February, 2006.

By the Commission

ATTEST:

  
Executive Director

STAFF REPORT  
ON  
EVERGREEN SEWAGE DISPOSAL, INC.  
CASE NO. 2005-00431

On October 19, 2005, Evergreen Disposal System, Inc. ("Evergreen") filed its application seeking to increase its rates for sewer service pursuant to Administrative Regulation 807 KAR 5:076. The test year upon which the application was based was the calendar year ended December 31, 2004. Evergreen's current flat monthly rate is \$22.55 to each customer receiving sewer service. Evergreen proposes to increase this rate by 55.21 percent to \$35. According to the information provided in Evergreen's application the proposed rate will produce revenues of \$15,120. Evergreen's application does not clearly detail how the revenue requirement of \$15,120 was determined.

Scott Lawless and Jessamyn Thompson of Commission Staff ("Staff") performed a limited review of Evergreen's test year operations to determine the reasonableness of the application. The scope of Staff's review was limited to obtaining information as to whether the test year operating revenues and expenses were representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

To perform its review Staff gathered records from Evergreen through a series of informal discovery requests. Staff's first informal request was made on October 31, 2005. Staff received the last of Evergreen's records necessary to complete its review on February 7, 2006.

This report summarizes Staff's findings and recommendations resulting from its review. Mr. Lawless is responsible for all areas of this report concerning revenue requirements while Ms. Thompson is responsible for normalized revenues and rate design.

Attachment A of this report details Evergreen's reported test year operations and Staff's adjustments thereto. Attachment A also includes narrative explanations for all test year adjustments proposed by Evergreen and recommended by Staff. Attachment B provides a comparison of Evergreen's and Staff's revenue requirement and rate calculations while Attachment C shows Evergreen's and Staff's calculation of the rate for service.

As shown in Attachment B Staff has calculated and recommends that the Commission approve a monthly flat rate of \$27.47. This rate is an increase of \$4.92 or 21.8 percent over Evergreen's current rate of \$22.55.

Signatures:

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Prepared by: Jack Scott Lawless, CPA  
Financial Analyst, Water and Sewer  
Revenue Requirements Branch  
Division of Financial Analysis

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Prepared by: Jessamyn Thompson  
Rate Analyst, Communications, Water,  
and Sewer Rate Design Branch  
Division of Financial Analysis

ATTACHMENT A  
STAFF REPORT 2005-00431  
STAFF'S ADJUSTED OPERATING STATEMENT

	Test Year	Adjustments		Pro Forma
Revenues from Residential Service	\$ 9,742	\$ 1,082 (A)		\$ 10,824
<b>Operating Expenses</b>				
Operation and Maintenance Expenses				
Owner Manager Fee	4,740	120 (B)		4,860
Sludge Hauling	2,390	(701) (C)		1,689
Utility Service - Water Cost	107			107
Fuel and Power Purchased	1,086			1,086
Chemicals	526		(D)	526
Miscellaneous Supplies and Expense	762			762
Maintenance of Pumping System	584		(D)	584
Flat Rate Inspections	649			649
Administrative and General Salaries				-
Office Supplies and Other Expenses	344			344
Miscellaneous and General Expense	550			550
Total Operating and Maintenance Expenses	11,738	(581)		11,157
Taxes Other Than Income Taxes	88			88
Depreciation	2,377	(2,377) (E)		-
Total Operating Expenses Before Taxes	14,203	(2,958)		11,245
Net Operating Income Before Taxes	\$ (4,462)	\$ 4,041		\$ (421)

A) Revenues from Residential Service. For the test year Evergreen reported operating revenues from rates of \$9,742. It did not propose adjustment to the test year amount. In its application Evergreen reported that 36 customer were receiving service as of the application file date.

Through informal discovery Staff obtained information from Earline Stone, President of Evergreen, stating that 40 customers are currently receiving sewer service. Farmdale Water District bills and collects sewer revenue from 26 customers on behalf of Evergreen while another 14 customers pay Evergreen directly. Based upon this

information Staff recommends that test year sewer service revenue be increased by \$1,082.

Present Flat Rate	\$22.55
Times: Number of Customers	40
Times: 12 Months	<u>12</u>
Pro forma	10,824
Less: Test year	<u>(9,741)</u>
Increase	<u>\$1,082</u>

B) Owner/Manager Fee. Evergreen records payments to its certified operator in the Owner/Manager Fee account. In May of the test year Evergreen's monthly operator fee increased from \$375 to \$405. The monthly rate continues to be \$405.

Evergreen proposed to increase this test year expense by \$200. Staff calculated the appropriate increase to be \$120. Staff recommends that the Commission deny Evergreen's proposed adjustment and approve the adjustment calculated by Staff and allow test year expenses to be increased by \$120 as calculated below.

Monthly fee	\$405
Times: 12 Months	<u>12</u>
Pro forma	4,860
Less: Test year	<u>(4,740)</u>
Adjustment	<u>\$120</u>

C) Sludge Hauling. During the test year Evergreen reported sludge hauling expense of \$2,390. Evergreen proposed to increase this amount by \$100 citing historic increases in this account from 2003 to 2004. Staff recommends that Evergreen's proposed adjustment be denied. It does not meet the rate making criteria of known and

measurable and is illogical. The increase in this expense account from 2003 to 2004 is already reflected in test year expenses since the test year is 2004.

As a part of its review Staff analyzed sludge hauling expenses for the most recent 4 years and noted a “spike” in 2004, the test year in this case. Staff recommends that the test year amount be decreased by \$701 to normalize or smooth this reported expense. A summary of the information reviewed by Staff is shown below.

Year	2002	2003	2004	2005
Annual Expense	\$1,290 <sup>1</sup>	\$1,230	\$2,390	\$1,155
Total Loads Hauled	8	7	14	6
Average Cost per Load	<u>\$161</u>	<u>\$176</u>	<u>\$171</u>	<u>\$193</u>

Staff calculated its adjustment by applying the most current annual average cost per load of \$193 for 2005 to the four year average number of loads, 8.75. The adjustment is detailed below.

Annual average loads	8.75
Times: 2005 average cost per load	<u>\$193</u>
Pro forma	1,689
Less: Test year	<u>(2,390)</u>
Adjustment	<u>\$(701)</u>

Through informal discovery Staff found that Evergreen switched sludge haulers in 2006. Evergreen states that the new hauler has a larger tanker truck and does a more efficient job than the previous hauler. The new hauler charges around \$300 per trip.

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<sup>1</sup> 2002 Annual Report shows sludge hauling expense to be \$1,540 but review of invoices showed that \$250 of that amount was for main line cleaning. Sludge hauling was actually \$1,290.

There is not enough information available for Staff to formulate an adjustment to test year expenses based on the new hauler information. Although the new hauler charges more per trip than the previous one, they use a larger tanker truck and in the opinion of Evergreen do a more efficient job than the previous hauler. Whether the switch to the new hauler will result in an increase or decrease in sludge hauling expenses relative to historical costs on an annual basis cannot be determined with the information currently available. It is Staff's opinion that its proposed adjustment is the most appropriate method of adjustment given the information currently available.

D) Chemicals and Maintenance of Pumping System. Evergreen proposed to increase each of these accounts by \$100 citing historic increases in these accounts from 2003 to 2004. Staff recommends that Evergreen's proposed adjustments be denied. They do not meet the rate making criteria of known and measurable and are illogical. The increases in these expense accounts from 2003 to 2004 are already reflected in test year expenses since the test year is 2004.

E) Depreciation. During the test year Evergreen reported depreciation expense at \$2,377. All the depreciation expense was from a plant acquired in 1978. Depreciation started accumulating on this plant in 1988. The Commission has previously ruled upon the rate-making treatment of this depreciation in case numbers 92-248<sup>2</sup> and 9514.<sup>3</sup> In both of those cases the Commission found that all plant acquired by Evergreen prior to 1980 was funded through contributions and recovery of related depreciation through

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<sup>2</sup> The Application of Evergreen Sewage Disposal System for a Rate Adjustment Pursuant to the Alternative Rate Riling Procedure for Small Utilities.

<sup>3</sup> The Application of Evergreen Sewage Disposal System, Inc., for an Adjustment of Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities.

rates was therefore inappropriate. There has been no evidence brought forth in this case showing that the Commission should reverse its previous rulings. Staff has removed depreciation expense from test year operations by decreasing test year depreciation expense by \$2,377.



ATTACHMENT B  
 STAFF REPORT CASE NO. 2005-00431  
 COMPARISON OF REVENUE REQUIREMENTS,  
 RATE CALCULATIONS AND PROVISION FOR INCOME TAXES

Staff used an 88 percent operating ratio to determine Evergreen's Revenue Requirements. This approach is frequently used by the Commission to determine revenue requirements for small, privately owned utilities and was used by the Commission in previous cases of Evergreen.

	Requested by Evergreen	Recommended by Staff
Calculation of Revenue Requirement		
Operating Expenses Before Income Taxes		\$ 11,245
Income Taxes		<u>357</u>
Total Operating Expenses		11,601
Divide by: Operating Ratio		<u>88%</u>
Revenue Requirement	\$ 15,120	13,183
Divided by: Number of Customers	36	40
Divided by: 12 months	<u>12</u>	<u>12</u>
Monthly Flat Rate per Customer	<u>\$ 35.00</u>	<u>\$ 27.47</u>
Calculation of Income Taxes		
Revenue Requirement		\$ 13,183
Less: Total Operating Expenses		<u>(11,601)</u>
Net Income Allowed After Taxes		1,582
Times: Gross-up Factor based on 4 percent State and 15 percent Federal Tax		<u>1.22549020</u>
Income Before Taxes		1,939
Less: Net Income Allowed After Taxes		<u>(1,582)</u>
Provision for Income Taxes		<u>\$ 357</u>