COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF WOODLAND ESTATES SEWAGE SYSTEM FOR AN ADJUSTMENT OF RATES PURSUANT TO THE ALTERNATIVE RATE FILING PROCEDURE FOR SMALL UTILITIES	))))	CASE NO. 2007-00397

O R D E R

On September 10, 2007, Woodland Estates Sewage System ("Woodland") applied for an adjustment in its sewer rate. Commission Staff, having performed a limited financial review of Woodland's operations, has prepared the attached report containing its 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 10 days from the date of this Order to submit written comments on the Staff Report or requests for a hearing or an informal conference. If no request for a hearing or informal conference is received within that period, this case shall stand submitted to the Commission for decision based upon the existing evidentiary record.

Done at Frankfort, Kentucky, this 21st day of November, 2007.

By the Commission

ATTEST:

Executive Director

STAFF REPORT

ON

WOODLAND ESTATES SEWAGE SYSTEM

CASE NO. 2007-00397

On September 10, 2007, Woodland Estates Sewage System ("Woodland") applied to increase its rate for sewer service pursuant to Administrative Regulation 807 KAR 5:076. The application was based on the test year ended December 31, 2006. Woodland's current flat monthly rate is $27 to each of the 24 customers receiving sewer service. Woodland proposes to increase this rate to $45, a 66.7 percent increase. In its application Woodland states that the proposed rate will produce annual revenues totaling $12,960.

Commission Staff ("Staff") performed a limited financial review of Woodland's test year operations to determine the reasonableness of Woodland's application. As part of Staff's limited review a field visit at Woodland's office was performed on October 8, 2007, to inspect Woodland's records. 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. Test year operations were adjusted by Staff for known and measurable changes.

This report summarizes Staff's findings and recommendations resulting from its review. Jack Scott Lawless is responsible for all portions of this report related to revenue requirements while Sam Reid is responsible for normalized revenues and rate design.

Attachment A of this report details Woodland's reported test year operations and Staff's known and measurable adjustments thereto. Attachment A also includes narrative explanations for all test year adjustments proposed by Staff. Attachment B provides a comparison of Woodland's and Staff's revenue requirement and flat monthly rate calculations.

As shown in Attachment B Staff has calculated and recommends that the Commission approve a flat monthly rate of $41.05. This rate is an increase of $14.05 or 52 percent over Woodland's current rate of $27.

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: Sam Reid, Branch Manager
Rate Analyst, Communications, Water,
and Sewer Rate Design Branch
Division of Financial Analysis

ATTACHMENT A
STAFF REPORT 2007-00397
STAFF'S ADJUSTED OPERATIONS

	Test Year	Adjustments	Ref.	Pro Forma
Operating Revenues	$ 7,539	$ 237	(A)	$ 7,776
Operating Expenses				
Sludge Hauling	760			760
Purchased Water	109	22	(B)	131
Chemicals	179	136	(C)	315
Purchased Power	931	85	(D)	1,016
Motor	348	(348)	(E)	-
Routine Maitenance Fee	2,750	250	(F)	3,000
Testing	355	120	(G)	475
Maintenance of Other Plant	95			95
Customer Accounts	300	3,300	(H)	3,600
Training	291	(145)	(I)	146
Property Taxes	25			25
PSC Fee	50			50
KPDES Permit	1,200	(900)	(J)	300
Depreciation	3,027	(3,027)	(K)	
		490	(L)	490
Total Operating Expenses	10,420	(17)		10,403
Net Operating Income	$ (2,881)	$ 254		$ (2,627)

(A) Operating Revenue. Test year sales of water were reported at $7,539. The test year amount has been increased by $237 to normalize revenues at present rates for the level of customers at the time of Staff's field visit. The adjustment is calculated below.

Present Flat Monthly Rate		$27
Times:	Number of Customers	24
	12 Months	12
Pro Forma Revenue		7,776
Less: Test Year		(7,539)
Increase		$237

(B) Purchased Water. Test year purchased water expense was stated at $109. Water service is provided to Woodland by Paintsville Utilities Commission. For each month of the test year the volume of water used by Woodland resulted in the assessment of a monthly $11 minimum bill by Paintsville. The purchased water expense reported for the test year included only 10 months of minimum payments. To annualize this expense Staff increased the test year amount by $22. The resulting pro forma expense of $131 properly accounts for a full year of purchased water expense.

(C) Chemicals. During the test year chemicals expense was stated at $179 for the purchase of chlorine. Subsequent to the test year the Kentucky Division of Water ("DOW") notified Woodland that it must begin dechlorinating its effluent. The dechlorination tablets are anticipated to cost Woodland $136 annually. Accordingly, Staff has increased test year chemical costs by $136 to account for this mandatory change in Woodland's treatment process.

(D) Purchased Power. Woodland reported test year purchased power expense of $931. The test year amount accounted for only 11 monthly payments to its electricity provider. To annualize the reported test year amount Staff recommends an increase of $85, the average monthly payment for purchased power for the 11 months included in the reported test year expenses ($931 test year purchased power / 11 months).

(E) Motor. Test-year expenses include the cost of a motor. The purchase of a motor is a capital expenditure for Woodland and should not be included in expenses. Staff has removed this amount from test year operating expenses and has included recovery of the cost of a motor in-service as well as a back-up motor in pro forma depreciation expense. A discussion of pro forma depreciation expense as calculated by Staff is included in this report at adjustment (L).

(F) Routine Maintenance Fee. During the test year Mike Ward performed Woodland's routine maintenance for a monthly fee of $250. At the time of Staff's field visit Mike Ward continued to provide Woodland's routine maintenance at the monthly rate of $250. Routine maintenance expense reported by Woodland for the test year of $2,750 accounts for only 11 months of service charges by Mr. Ward. To annualize the test year expense Staff has increased the test year amount by $250. Pro forma expenses then account for a full year of routine maintenance costs of $3,000 ($250 monthly fee x 12 months)

(G) Testing. Woodland submits effluent samples to McCoy & McCoy Laboratories for testing at a quarterly charge of $120. The test year expense includes only three quarterly charges. Staff has increased test year expenses by $120 to annualize test year testing expense.

(H) Customer Accounts/Owner Manager Fee. Woodland stated test year customer accounts expense at $300. This amount represents an allocation of administrative and general costs absorbed by Butcher Enterprises, Inc., the owner of Woodland. For small sewer utilities the Commission generally limits an owner manager fee to $3,600 for overseeing the daily operations of the utility. When a utility is as small as Woodland the Commission has considered the owner manager fee to be adequate compensation for overseeing daily operations as well as administrative and general expenses associated with bookkeeping, maintaining customer accounts, office telephone, office rent, computer services, office supplies, etc. Staff recommends this approach be applied in the current case and has included $3,600 in revenue requirements.

(I) Training. Test year expenses include training costs of $291 paid on behalf of Paul Butcher to retain his wastewater treatment plant operator's license. This training fulfilled all the requirements of the license which has a two-year life. Staff recommends that test year expenses be decreased by $145 to account for the two year amortization of this training expense. Staff's method recognizes the training expense over the life of the license.

(J) Kentucky Pollutant Discharge Elimination System ("KPDES") Permit. Woodland must renew its KPDES permit with DOW every five years. The total cost of the permit is $1,500. Test year expenses include $1,200 of this expense. Staff recommends that test year expenses be reduced by $900 to account for the five-year amortization of the total permit's cost. The adjustment is calculated below.

Permit Fee	$1,500
Divide by: Five Years	5
Annual Recovery	300
Less: Test Year	(1,200)
Decrease	($900)

(K) Depreciation. Prior to 1996 Woodland had no depreciable basis in its utility plant in service. This was reflected in Woodland's annual reports filed with the Commission and Woodland's current rates approved by the Commission in Case No. 1992-00474. In 1996 Paul Butcher, the current owner of the Woodland, inherited Woodland's sewer plant through his father's estate. At that time the fair market value of the plant was determined to be $51,300. This amount was recorded by Woodland as the cost basis of the plant and depreciated using tax basis depreciation rates and methods. Test year depreciation resulting from this accounting treatment totaled $3,027.

The accounting entries to record the inherited plant in 1996 violate the original cost method of accounting as required by Utility Plant Instruction 1. A. as stated at page 18 of the Sewer Uniform Systems of Accounts as prescribed by the Kentucky Public Service Commission. All accounting entries related to the 1996 recording of plant and subsequent depreciation should be reversed and removed from the financial statements to be filed as a part of Woodland's 2007 annual report. Test year depreciation of this plant has been removed by Staff to calculate pro forma operations in this case.

(L) Depreciation. Subsequent to the test year Woodland replaced the plant's motor, starter and control panel wiring. The wiring repairs were necessary due to age and wear as evidenced by the frequent replacement of the motor over the past several years. The replacements were completed on September 18, 2007, at a total cost of $2,114 including installation costs. At the recommendation of the Commission's Division of Engineering, a 10-year life has been applied to this improvement for depreciation purposes resulting in an annual recovery of $211 ($2,114 total cost / 10 years).

The DOW requires that Woodland maintain a back-up blower and motor unit for stand-by purposes. Even though these units are not in service, Staff recommends that recovery over their estimated useful life of 10 years be allowed. Otherwise, there is no provision for rate recovery. Once these costs have been recovered there should be no further allowance for depreciation of these specific units whether they are placed into service or not. The 10-year depreciable life was recommended by the Commission's

Engineering Division. The total cost of the stand-by blower and motor including installation is $2,788. The 10 year depreciation of this cost results in an annual expense of $279 ($2,788 total cost / 10 years).

Staff's recommendations result in a total increase to depreciation of $490 ($211, motor, starter and wiring + $279, back-up units).

ATTACHMENT B
STAFF REPORT CASE NO. 2007-00397
COMPARISON OF REVENUE REQUIREMENT
AND RATE DETERMINATION

	Woodland	Staff
Calculation of Revenue Requirement		
Operating Expenses	$ 11,405	$ 10,403
Divide by: 88 Percent Operating Ratio	88%	88%
Revenue Required	12,960	11,822
Less: Present Rate Revenue	(7,776)	(7,776)
Required Revenue Increase	$ 5,184	$ 4,046
Calculation of Monthly Flat Rate		
Required Revenue	12,960	$ 11,822
Divide by: Number of Customers	24	24
12 Months	12	12
Monthly Flat Rate	$ 45.00	$ 41.05

Staff used an 88 percent operation ratio to determine Woodland's Revenue Requirements. This approach is frequently used by the Commission to determine revenue requirements of small, privately owned utilities and was used by the Commission in Woodland's previous rate study in Case No. 1992-00474.