

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF FARMDALE DEVELOPMENT )  
CORPORATION FOR AN ADJUSTMENT IN )  
RATES PURSUANT TO THE ALTERNATIVE ) CASE NO. 2007-00436  
RATE FILING PROCEDURE FOR SMALL )  
UTILITIES )

O R D E R

On October 3, 2007, Farmdale Development Corporation ("Farmdale") filed an application for Commission approval of its proposed sewer rates pursuant to the alternative rate filing procedure for small utilities. Commission Staff, having performed a limited financial review of Farmdale'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 on Staff's findings and recommendations or requests for a hearing or an informal conference within 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 regarding the attached Staff Report or to request a hearing or an informal conference. If no request for a hearing or an informal conference is received by that date, this case shall stand submitted to the Commission for decision.

Done at Frankfort, Kentucky, this 11<sup>th</sup> day of February, 2008.

By the Commission

ATTEST:



Executive Director

STAFF REPORT  
FARMDALE DEVELOPMENT CORPORATION  
CASE NO. 2007-00436

On October 3, 2007, Farmdale Development Corporation (“Farmdale”) filed its application seeking to increase its rates pursuant to 807 KAR 5:076. This regulation provides for a simplified and expedited rate procedure for small utilities to save time and expenses. Farmdale’s current rate is a flat monthly fee of \$28.00. Farmdale proposes to increase its current flat rate by 52.64 percent to \$42.75, which would produce increased revenues of \$42,653.

In order to evaluate the requested monthly increase, Commission Staff (“Staff”) performed a limited financial review of Farmdale’s test period operations for the calendar year ending December 31, 2006. 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. Based on its review Staff recommends a revenue increase of \$8,260, or 10.2 percent, which would result in a monthly flat rate of \$30.86 per customer, as shown in Attachment A to this report.

Eddie Beavers is responsible for all revenue adjustments and the calculation of the proposed rates. Jack Kaninberg is responsible for the determination of the revenue requirement. Based on the recommendations herein, Staff is of the opinion that the rates as shown in Attachment B of this report are reasonable and should be approved by this Commission.

Signatures

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

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

ATTACHMENT A  
STAFF REPORT CASE NO. 2007-00436

| Farmdale Development Attachment A | 2006 Actual       | Proposed Adjstmts. | Proposed Adjusted | Staff Adjustmts.  | Ref. | Staff Adjusted  |
|-----------------------------------|-------------------|--------------------|-------------------|-------------------|------|-----------------|
| Flat-Rate Revenue                 | \$53,273          | \$27,703           | \$80,976          | 0                 | A    | \$80,976        |
| Owner/Manager fee                 | \$9,600           | 0                  | \$9,600           | (\$3,600)         | B    | \$6,000         |
| Sludge Hauling                    | \$5,450           | 0                  | \$5,450           | (\$2,850)         | C    | \$2,600         |
| Water Cost                        | \$1,646           | 0                  | \$1,646           | (\$24)            | D    | \$1,622         |
| Other-Labor, Matl, & Exp.         | \$7,485           | \$315              | \$7,800           | 0                 |      | \$7,800         |
| Fuel/Power for Pumping            | \$19,150          | 0                  | \$19,150          | (\$3,847)         | E    | \$15,303        |
| Chemicals                         | \$2,402           | 0                  | \$2,402           | 0                 |      | \$2,402         |
| Routine Mt. Fee                   | \$11,370          | (\$1,650)          | \$9,720           | 0                 |      | \$9,720         |
| Mt.-Collection System             | \$350             | 0                  | \$350             | 0                 |      | \$350           |
| Mt. Of Trtmnt & Disp.             | \$19,712          | (\$13,091)         | \$6,621           | (\$2,233)         | F    | \$4,388         |
| Mt. of Other                      | \$1,540           | 0                  | \$1,540           | (\$532)           | G    | \$1,008         |
| Agency Collection Fee             | \$7,991           | \$14,943           | \$22,934          | (\$14,837)        | H    | \$8,097         |
| Office Supplies/Other             | \$278             | 0                  | \$278             | 0                 |      | \$278           |
| Outside Serv. Employed            | \$5,709           | (\$1,980)          | \$3,729           | (\$729)           | I    | \$3,000         |
| Insurance Expense                 | \$543             | 0                  | \$543             | 0                 |      | \$543           |
| Reg. Commission Exp.              | \$590             | 0                  | \$590             | 0                 |      | \$590           |
| Miscellaneous Expense             | \$26              | 0                  | \$26              | 0                 |      | \$26            |
| Rents                             | \$600             | 0                  | \$600             | 0                 |      | \$600           |
| <i>Total Sewer O&amp;M</i>        | <i>\$94,442</i>   | <i>(\$1,463)</i>   | <i>\$92,979</i>   | <i>(\$28,652)</i> |      | <i>\$64,327</i> |
| Depreciation Expense              | \$118             | \$3,081            | \$3,199           | \$234             | J    | \$3,433         |
| Amortization Expense              | 0                 | \$3,734            | \$3,734           | \$363             | K    | \$4,097         |
| Taxes OT Income                   | \$1,142           | 0                  | \$1,142           | 0                 |      | \$1,142         |
| <b>Total Op. Expense</b>          | <b>\$95,702</b>   | <b>\$5,352</b>     | <b>\$101,054</b>  | <b>(\$28,055)</b> |      | <b>\$72,999</b> |
| Income Taxes                      | \$175             | 0                  | \$175             | 0                 |      | \$175           |
| Interest Expense                  | \$893             | \$7,703            | \$8,596           | (\$2,313)         | L    | \$6,283         |
| <i>Total Expense</i>              | <i>\$96,770</i>   | <i>\$13,055</i>    | <i>\$109,825</i>  | <i>(\$30,368)</i> |      | <i>\$79,457</i> |
| <i>Net Income</i>                 | <i>(\$43,497)</i> | <i>\$14,648</i>    | <i>(\$28,849)</i> | <i>\$30,368</i>   |      | <i>\$1,519</i>  |

**Calculation of Revenue Requirement using Operating Ratio Method:**

|             |   |
|-------------|---|
| \$ 72,999   | Proforma Operating Expenses                   |
| 88%         | Operating Ratio                               |
| \$ 82,953   | Subtotal                                      |
| \$ 6,283    | Plus Recommended Interest Expense             |
| \$ 89,236   | Revenue Requirement                           |
| (\$ 80,976) | Less Normalized Revenues                      |
| \$ 8,260    | Recommended Revenue Increase (10.2% Increase) |

\$89,236 / 12 = \$7,436.33 divided by 241 customers = \$30.856 per month bill

**Explanatory Notes:**

**A. Revenues** – Normalized revenues as determined by Staff's billing analysis.

**B. Owner/Manager Fee** – The Commission normally allows an owner/manager fee of \$3,600 to compensate the owner/manager of a small sewer utility. In this case, Farmdale is proposing an owner/manager fee of \$9,600, and justifies this expense with a comparison to the salaries paid to water district commissioners, arguing that the duties and responsibilities of Farmdale’s owner are greater than those of a water district commissioner.

Commission Staff is not persuaded that Farmdale’s owner has greater duties than a water district commissioner, and thus is entitled to greater compensation. However, Staff does note that KRS 74.020(6) provides annual compensation of \$6,000 for water district commissioners who, among other things, meet certain training requirements. This statute at subsection (7)(c) encourages “training programs that enhance a water district commissioner’s understanding of his or her responsibilities and duties.” If the intent of the statute is to encourage the employment of well-qualified utility management personnel, Staff believes Farmdale’s owner meets this criterion based on his 30-plus years of experience owning and operating jurisdictional sewer utilities. Although there is no specific statute mandating the compensation to be paid to sewer owner/managers, Staff recommends the allowance of an owner/manager fee of \$6,000 in this case based on the owner’s experience level.

**C. Sludge Hauling Expense** – was adjusted by \$2,850 to reduce the 2006 sludge hauling expense of \$5,450 to the \$2,600 amount which was incurred in 2005 and allowed in Farmdale’s most recent rate case. The justification for this recommendation is that Farmdale’s sludge hauling expenses appear to have been abnormally high in 2006. This observation is based on a comparison of Farmdale’s reported expenses both prior to and following the 2006 test period. Farmdale’s historical sludge hauling costs have been as follows:

| Year        | Sludge Hauling Expense |
|-------------|------------------------|
| 2002        | \$2,360                |
| 2003        | \$1,120                |
| 2004        | \$1,120                |
| 2005        | \$2,600                |
| <b>2006</b> | <b>\$5,450</b>         |

Subsequent to 2006, Farmdale paid sludge hauling expenses totaling \$1,975 through June 30, 2007. However, of that amount \$1,550 was actually incurred for service rendered in November and December 2006, leaving only \$425 in expense for sludge hauling done and paid for in the first six months of 2007.

When Farmdale was asked to explain whether the sludge hauling done in 2006 was higher than normal, it responded that this was not the case, suggesting only that sludge builds up at a variable rate. Staff believes that a trend analysis of this expense both before and after 2006 suggests something unusual – perhaps catch-up maintenance or increase scrutiny because of the rate case filed in 2006 -occurred during 2006 to cause this expense to increase on a temporary basis.

**D. Water Cost** – was adjusted to remove late payment fees incurred on two payments totaling \$24.

**E. Fuel/Power for Pumping** – was adjusted to the amount of \$15,303 expensed in 2005 and recommended in Farmdale’s prior rate case. Similar to sludge hauling, a trend analysis of reported electricity expense suggests that the amount incurred in 2006 was abnormally high and decreased subsequent to 2006. Farmdale’s historical electricity costs have been as follows:

| Year        | Fuel/Power for Pumping Expense |
|-------------|--------------------------------|
| 2002        | \$7,494                        |
| 2003        | \$9,549                        |
| 2004        | \$9,940                        |
| 2005        | \$15,303                       |
| <b>2006</b> | <b>\$19,150</b>                |

Subsequent to 2006, Farmdale paid electricity expenses totaling \$7,025 for six bills paid through June 30, 2007, which if annualized would result in electricity expense of \$14,050, a significant reduction from the \$19,150 expensed in 2006. Therefore, Staff recommends that the pro forma electricity expense allowed in the most recent rate case of \$15,303 be allowed in this case.

**F. Maintenance of Treatment and Disposal Expenses** – Farmdale proposed to adjust this expense by \$13,091 to remove several capital expenditures approved in the last case, the rate recovery of which was allowed in depreciation expense. Staff recommends accepting this adjustment, and further recommends that the following two nonrecurring expenditures totaling \$2,232.81 be removed from test period operations and recovered over a multi-year period:

| Invoice Date | Item Expensed                      | Amount            |
|--------------|------------------------------------|-------------------|
| 1/12/06      | New motor, materials, labor, etc.  | \$1,635.29        |
| 11/30/06     | Survey of sewer mains and manholes | \$597.52          |
|              | <b>Total</b>                       | <b>\$2,232.81</b> |

**G - Maintenance of Other** – Farmdale paid grass cutting charges of \$1,540 in 2006. In Farmdale’s most recent rate case, Staff questioned why Farmdale’s ratepayers should pay extra for grass cutting because of higher gasoline expenses paid to a Louisville contractor, and recommended reducing allowable grass cutting expenses to \$144 per month for 7 months, or \$1,008. Staff recommends a similar adjustment in this case, reducing pro forma grass cutting expenses by \$532.

**H. Agency Collection Fee** – Farmdale proposed a pro forma Agency Collection Fee Expense of \$22,934, a 187 percent increase over the \$7,991 collection fee expensed in 2006. In Farmdale’s most recent rate case decided in April, 2007, Staff recommended allowance of \$8,097 in collection fees, while noting that this expense amounted to \$2.74 per month per customer. Because of the high cost of this service to Farmdale’s customers, Staff strongly suggested that Farmdale consider more economical alternatives to its present billing and collection service in the future.

At this time, Farmdale’s proposed Agency Collection Fee, if allowed, would amount to \$7.93 per month per customer. Simply stated, the only reason for this increased cost is the rate increase granted to Farmdale in 2007, because the billing and collection fee paid to Farmdale Water District is based upon 15 percent of Farmdale Development’s revenues. The net result is that whenever Farmdale Development’s sewer rate increases, its billing and collection expense will increase, so this arrangement either contributes to sewer rates higher than they would otherwise be or contributes to additional rate increases in the future. Farmdale noted in its rate application that it “failed to include the collection fee on increased revenues in its previous rate case,” and this fee’s proposed increase of \$14,943 is by far the largest expense increase proposed by Farmdale in this case.

Farmdale’s proposed billing and collection expense per customer is far higher than that of other jurisdictional sewer utilities around the state who list Agency Collection Fees in their PSC annual reports, as shown by the following comparison with six other sewer utilities:

| Utility                 | 2006 Expense    | 2006 Customers | Expense per customer | Expense per cust. per month |
|-------------------------|-----------------|----------------|----------------------|-----------------------------|
| Airview Utilities       | \$4,738         | 201            | \$23.57              | \$1.96                      |
| Bullitt Utilities       | \$9,958         | 691            | \$14.41              | \$1.20                      |
| Hillridge Facilities    | \$8,091         | 712            | \$11.36              | \$0.95                      |
| Lake Columbia Util.     | \$470           | 33             | \$14.24              | \$1.19                      |
| Lewis Sanitation        | \$669           | 111            | \$6.03               | \$0.50                      |
| Pioneer Village         | \$8,201         | 944            | \$8.68               | \$0.72                      |
|                         |                 |                |                      |                             |
| <b>Total of above 6</b> | <b>\$32,127</b> | <b>2,692</b>   | <b>\$11.94</b>       | <b>Average - \$0.99</b>     |

In fact, it is remarkable that Farmdale's proposed expense per customer is much closer to the average annual expense of \$11.94, not the monthly average expense of 99 cents per customer.

This Commission has expressed longstanding concerns with the high cost of the billing and collection services provided by the Farmdale Water District. Other sewer utilities in Farmdale's general vicinity are paying a similar billing and collection fee. The Commission in 1999 questioned the reasonableness of similar fees paid by 4-Way Enterprises (aka Coolbrook Sanitation), another small sewer utility in Franklin County. In the Commission's Order approving new rates for 4-Way, it stated the following:

*"After reviewing the record, the Commission concurs with Commission Staff's recommendation that the billing and collection expense not be increased from the test year level of \$13,664. In addition, it finds that when filing its next application 4-Way should be required to present evidence that its billing and collection expense is reasonable. Reasonableness may be presumed if 4-Way advertises and receives public bids for its billing and collection."*

In this case, Farmdale was asked to provide competitive bids for billing and collection services. In response, Farmdale stated that the billing and collection services it receives are unique because Farmdale Water District has the ability to turn off water for nonpayments, and is immediately aware of new customers, cancellations, and new and changed billing addresses. Therefore, Farmdale suggested that no entity or individual could provide a truly competitive bid, but that it would attempt to obtain bids from qualified companies. No such bids have been forthcoming.

Farmdale did provide evidence that it attempted to negotiate a reduced expense with Farmdale Water District, but to no avail. Under these circumstances - and especially given the above expense comparisons - Staff cannot recommend allowance of the proposed billing and collection expense of \$22,934. Instead, Staff recommends that the pro forma expense of \$8,097 recommended in the most recent rate case be allowed in this case, and that Farmdale should aggressively pursue all reasonable billing and collection alternatives that would greatly reduce this cost to its customers.

**I. Outside Services Employed** - was adjusted by \$729 to remove nonrecurring charges from Smither Consulting related to the plant improvements which were addressed in Case No. 2006-00028. Recovery of these expenses over a multi-year period has been provided for in Amortization Expense.

**J. Depreciation Expense** – was adjusted to allow multi-year recovery of the motor installation costing \$1,635.29 which was removed from Maintenance of Treatment/Disposal Expense. The Commission Staff's Engineering Division recommends depreciating this item over 7 years, resulting in an adjustment of \$233.61.

**K. Amortization Expense** - was adjusted by \$363 to allow multi-year recovery for two nonrecurring expense items removed above, as follows:

| Expense Account                | Item Expensed                      | Cost     | Years        | Annual Amount   |
|--------------------------------|------------------------------------|----------|--------------|-----------------|
| Maintenance-Treatment/Disposal | Survey of sewer mains and manholes | \$597.52 | 5            | \$119.51        |
| Outside Services Employed      | Smither Consulting Fees            | \$729.00 | 3            | \$243.00        |
|                                |                                    |          | <b>Total</b> | <b>\$362.51</b> |

**L. Interest Expense** – was adjusted to remove Interest Expense of \$2,313 on a one-year renewable \$25,000 loan from National City Bank. Farmdale was asked to explain the uses of the loan, and whether and why this expense might be expected to recur on an annual basis. Farmdale provided no response as to the latter, and as to the former, Farmdale responded that it was used to pay legal bills, accounting fees,



and other bills that were due, and “to pay a part of the operating expenses, as the former rate was not sufficient to pay all the normal operating expenses.” Historically, the Commission has not allowed utilities to recover interest on loans incurred to cover operating expenses, because it is the responsibility of the owner to monitor the utility’s financial condition and seek rate relief in a timely manner (see, for instance, Case No. 2005-00235, The Application of Mallard Point Disposal Systems, Inc. For An Adjustment Of Rates Pursuant To The Alternative Rate Filing Procedure For Small Utilities, Staff Report Appendix C at page 12, dated October 12, 2005). Therefore, Staff recommends that this Interest Expense be removed from pro forma operations.

ATTACHMENT B  
STAFF REPORT CASE NO. 2007-00436  
STAFF'S RECOMMENDED RATES

Monthly Sewer Rate

Flat Residential Rate

\$30.86