

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

| | | |
|--------------------------------------|---|------------|
| APPLICATION OF THE R. A. WILLIAMS |) | |
| DEVELOPMENT CO., INC. D/B/A |) | |
| CEDARBROOK TREATMENT PLANT FOR THE |) | CASE NO. |
| APPROVAL OF THE PROPOSED INCREASE IN |) | 2008-00042 |
| RATES FOR WATER SERVICE |) | |

ORDER

On February 4, 2008, R. A. Williams Development Co., Inc. d/b/a Cedarbrook Treatment Plant (“Cedarbrook”) applied to the Commission for an adjustment in water rates. Commission Staff, having performed a limited financial review of Cedarbrook’s operations, has prepared the attached report containing Staff’s findings and recommendations regarding the proposed rates. All parties should review the report carefully and submit any written comments on Staff’s findings and recommendations or requests for a hearing or informal conference no later than 14 days from the date of this Order.

IT IS THEREFORE ORDERED that:


1. All parties shall, no later than 14 days from the date of this Order, submit written comments, if any, regarding the attached Staff Report or requests for a hearing or an informal conference.
2. Any party requesting a hearing shall include in its request its comments as to the particular finding of the Staff Report to which it objects and a brief summary of testimony that it would present at hearing.

3. If no request for a hearing or an informal conference is received within the 14 days, this case shall stand submitted to the Commission for decision.

Done at Frankfort, Kentucky, this 1st day of April, 2008.

By the Commission

ATTEST:


Executive Director

STAFF REPORT

ON

R. A. WILLIAMS DEVELOPMENT CO., INC.

D/B/A CEDARBROOK TREATMENT PLANT

CASE NO. 2008-00042

Pursuant to a request by R. A. Williams Development Co., Inc. d/b/a Cedarbrook Treatment Plant (“Cedarbrook”) for assistance with the preparation of a rate application, Commission Staff performed a limited financial review of Cedarbrook’s test period operations, 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.

Upon completion of its limited review, Staff presented to Cedarbrook a draft rate application containing a pro forma income statement reflecting Staff’s findings and recommendations. On February 4, 2008, Cedarbrook submitted its rate application to the Commission for consideration. Cedarbrook and Cedarbrook Utilities, LLC jointly submitted an application on February 14, 2008 requesting approval of the transfer of the treatment and collection facilities from Cedarbrook to Cedarbrook Utilities, LLC, which the Commission docketed as Case No. 2008-00040.¹

Cedarbrook accepted the findings and recommendations of Staff’s review and included those as its pro forma operating statement in its application, which is appended

¹ Case No. 2008-00040, Joint Application of R.A. Williams Construction Company, Inc. and Cedarbrook Utilities, LLC for Approval of the Transfer of Wastewater Treatment Plant to Cedarbrook, Utilities, LLC.

hereto as Attachment A. Given the proposed transfer of ownership of Cedarbrook's assets, Staff is revising the original findings and recommendations of its field review. Staff's revised pro forma operations and explanations of its revisions are attached hereto as Appendix B.

Eddie Beavers of the Commission's Division of Financial Analysis is responsible for the pro forma revenue adjustment and the calculation of the recommended rate. Mark Frost of the same division is responsible for all pro forma expense adjustments, the revised pro forma adjustments, and the revenue requirement determination.

Cedarbrook determined that its requested pro forma operations would support a revenue requirement from rates of \$37,937, an increase of \$23,525 or 163.232 percent above the normalized revenue from rates of \$14,412. Using its requested revenue requirement, Cedarbrook calculated a flat monthly rate of \$62.00. As shown in Appendix C of this report, Staff's revised pro forma operations combined with an 88 percent operating ratio results in a revenue requirement from rates of \$28,392, an increase of \$13,980 or 97.002 percent above the normalized revenue from rates of \$14,412. The calculation of Staff's recommended flat residential rate of \$46.40 is contained in Appendix C.

Staff's recommended revenue requirement from rates will allow Cedarbrook to cover its pro forma operating expenses, and provide for future equity growth. The rate contained in Attachment C will produce the revenue requirement determined reasonable herein of \$28,392, and therefore, Staff recommends that the Commission accept that rate.

Signatures

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

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

APPENDIX A
STAFF REPORT CASE NO. 2008-00042
CEDARBROOK'S REQUESTED
PRO FORMA OPERATIONS

| | Test Period Actual | Pro Forma Adjustments | Ref. | Pro Forma Operations |
|---------------------------------|-----------------------|--------------------------|------|-------------------------|
| Operating Revenues: | | | | |
| Residential | \$ 13,813 | \$ 599 | (a) | \$ 14,412 |
| Misc. Operating Revenues | 411 | 0 | | 411 |
| Total Operating Revenues | <u>\$ 14,224</u> | <u>\$ 599</u> | | <u>\$ 14,823</u> |
| Operating Expenses: | | | | |
| Operation & Maint. Exp: | | | | |
| Sludge Hauling | \$ 4,383 | \$ (3,054) | (b) | \$ 1,329 |
| Utility Service - Water | 408 | 0 | | 408 |
| Testing/Analysis of Effluent | 0 | 1,896 | (c) | 1,896 |
| Electricity | 2,879 | 0 | | 2,879 |
| Chemicals | 1,308 | (150) | (d) | 1,158 |
| Misc Sup & Exp – Treat. & Disp. | 8,785 | (8,785) | (e) | 0 |
| Routine Maintenance Fee | 8,590 | 122 | (f) | 8,712 |
| Maintenance | 0 | 3,825 | (g) | 3,825 |
| Office Supplies | 34 | 0 | | 34 |
| Outside Services - Legal | 0 | 78 | (h) | 78 |
| Outside Services - MGT | 13,865 | (1,865) | (i) | 12,000 |
| Total Operation & Maint. Exp. | <u>\$ 40,252</u> | <u>\$ (7,933)</u> | | <u>\$ 32,319</u> |
| Depreciation | 511 | (257) | (j) | 254 |
| Amortization | 0 | 1,181 | (k) | 1,181 |
| Taxes Other than Income Tax | 107 | 0 | | 107 |
| Total Operating Expenses | <u>\$ 40,870</u> | <u>\$ (7,009)</u> | | <u>\$ 33,861</u> |
| Net Operating Income | <u>\$ (26,646)</u> | <u>\$ 7,608</u> | | <u>\$ (19,038)</u> |
| Other Income: | | | | |
| Interest Dividend Income | 130 | 0 | | 130 |
| Net Income | <u>\$ (26,516)</u> | <u>\$ 7,608</u> | | <u>\$ (18,908)</u> |

a. Normalized Operating Revenues - Residential:

Revenue normalization using end-of-period customer level and the current tariffed rate.

| | | |
|---|----|--------|
| Current Tariffed Rate | \$ | 23.55 |
| Multiplied by: Residential End-of-Period | x | 51 |
| Monthly Revenue | \$ | 1,201 |
| Multiplied by: 12-Months | x | 12 |
| Normalized Annual Revenues from Rates | \$ | 14,412 |
| Less: Reported Residential Operating Revenues | - | 13,813 |
| Pro Forma Adjustment | \$ | 599 |

b. Sludge Hauling Expense:

In the test-period, Cedarbrook expensed several items (CCTV Sewer lines, Root Cutting, and Cleaning the Creek) that are considered nonrecurring and should be removed from expenses and amortized. Also, a prior period expenditure has been removed from the test-period operations. To reflect the removal of the prior period and the non-recurring costs, sludge hauling expense has been reduced by \$4,782. The associated amortization is discussed in a following adjustment.

| Invoice Date | Description | Amount |
|---------------------------------------|---|------------|
| 01/03/06 | Cleaning Creek & Pumping Treatment Plant - 11/30/05 | \$ 300.00 |
| 01/31/06 | Cleaning out the creek - 1/4/06 | 300.00 |
| 01/31/06 | Cleaning out the creek - 1/22/06 | 300.00 |
| 02/20/06 | CCTV of Sewer Lines | 1,982.00 |
| 02/20/06 | Root Cutting (Flat Rate) | 1,000.00 |
| 03/07/06 | Cleaning out the creek - 2/2/06 | 300.00 |
| 03/07/06 | Pump Digester & Chlorine Basin - 2/27/06 | 318.00 |
| 08/01/06 | Pumping Treatment Plant | 159.00 |
| 08/01/06 | Cleaning out the creek | 300.00 |
| 08/01/06 | Pumping Treatment Plant | 159.00 |
| 11/02/06 | Cleaning out the creek | 300.00 |
| 11/02/06 | Pumping rear lift station | 375.00 |
| 11/02/06 | Pump Chlorine Basin & skim clarifier | + 318.00 |
| Sludge Hauling Expense | | \$ 6,111 |
| Less: CCTV & Root Cutting | | (2,982) |
| Less: Creek Cleaning | | (1,500) |
| Less: Prior Period Expenditure | | + (300) |
| Test-Period Sludge Hauling Expense | | \$ 1,329 |
| Less: Reported Sludge hauling Expense | | - 4,383 |
| Pro Forma Adjustment | | \$ (3,054) |

c. Testing/Analysis:

Currently Cedarbrook is paying Fouser Environmental a monthly testing fee of \$158. This adjustment reflects the annual testing cost of \$1,896.

| | | |
|---------------------------------|----|-------|
| Monthly Testing/Analysis Fee | \$ | 158 |
| Multiplied by: 12-Months | x | 12 |
| Annual Testing/Analysis Expense | \$ | 1,896 |

d. Chemicals:

This adjustment reflects the actual test-period chemical costs.

| <u>Invoice Date</u> | <u>Vendor</u> | <u>Description</u> | <u>Amount</u> |
|---------------------------------|----------------------|--------------------|---------------|
| 01/31/06 | Brocklyn Utilities | Chlorine Test Kit | \$ 120.25 |
| 02/20/06 | Farmdale Development | 1 - 100LB HTH Drum | 140.95 |
| 02/20/06 | Brocklyn Utilities | Chlorine Tablets | 148.40 |
| 03/30/06 | Brocklyn Utilities | Chlorine Tablets | 148.40 |
| 05/31/06 | Brocklyn Utilities | Chlorine Tablets | 148.40 |
| 10/20/06 | Covered Bridge | Chlorine Tablets | 105.00 |
| 12/02/06 | Covered Bridge | 1 - 100LB HTH Drum | 149.40 |
| 12/02/06 | Covered Bridge | Chlorine Tablets | + 198.75 |
| Test-Period Chemical Expense | | | \$ 1,159.55 |
| Less: Reported Chemical Expense | | | - 1,308.00 |
| Pro Forma Adjustment | | | \$ (148.45) |

e. Misc Sup & Exp - Treatment & Disp.:

Expenditures reported in this account have been transferred to the correct accounts.

| | |
|------------------------|------------|
| Misclassified Expenses | \$ (8,785) |
|------------------------|------------|

f. Maintenance:

In the test-period, Cedarbrook expensed several items that are considered to be capital expenditures that should be removed from expenses and depreciated. Those costs have been removed and operating expenses increased by \$3,825 to reflect test-period maintenance expense. The associated depreciation is discussed in a following adjustment.

| <u>Invoice Date</u> | <u>Vendor</u> | <u>Description</u> | <u>Amount</u> |
|---------------------------------|----------------------|---|---------------|
| 01/31/06 | Camden Environmental | Supplies & labor for blower motor assembly | \$ 88 |
| Multiple Visits | Camden Environmental | Local Serviceman Extra Visit - I/I Problems | 900 |
| 03/07/06 | Camden Environmental | Extra Time Feb. Sludge return problems | 45 |
| 06/30/06 | Camden Environmental | Mow & Trim plant site 3 @ \$25 | 75 |
| 11/02/06 | Camden Environmental | Mow & Trim plant site | 350 |
| 01/17/06 | Covered Bridge | Installed Used Blower | 1,363 |
| 01/31/06 | Covered Bridge | | 230 |
| 02/20/06 | Covered Bridge | Installed used blower motor | 633 |
| 04/13/06 | Covered Bridge | Installed New Sheaves - Plant Blower | 458 |
| 05/19/06 | Covered Bridge | New Diffusers | 1,090 |
| 09/25/06 | Covered Bridge | Cleaned Building/Service Blower | 549 |
| 10/20/06 | Covered Bridge | Service effluent pump | 334 |
| 11/02/06 | Covered Bridge | Repair electrical starter on blower motor | 230 |
| 12/02/06 | Covered Bridge | Repaired Effluent Pump | + 566 |
| Subtotal | | | \$ 6,911 |
| Remove: | | | |
| | Used Blower | | (1,363) |
| | Used Blower Motor | | (633) |
| | New Diffusers | | + (1,090) |
| Test-Period Maintenance Expense | | | \$ 3,825 |

g. Routine Maintenance:

Currently Cedarbrook is paying Camden Environmental a monthly fee of \$726 for a licensed wastewater operator. This adjustment reflects the annual maintenance cost of \$8,712.

| | | |
|--|----|-------|
| Monthly Routine Maintenance Fee | \$ | 726 |
| Multiplied by: 12-Months | x | 12 |
| Normalized Routine Maintenance Expense | \$ | 8,712 |
| Less: Reported Routine Maintenance Expense | - | 8,590 |
| Pro Forma Adjustment | \$ | 122 |

h. Outside Services Employed - Legal

Test-period operating expenses have been increased to reflect the legal fees incurred for collecting past-due accounts

| | | | | |
|----------|---------------|------------------------|----|----|
| 11/01/06 | Cecil F. Dunn | Collection of Accounts | \$ | 78 |
|----------|---------------|------------------------|----|----|

i. Outside Services Employed

Ronald Osborne, Cedarbrook's owner has entered into a contract with Covered Bridge Utilities to manage and operate Cedarbrook for a fee of \$1,000 per month. This adjustment reflects the annual cost of the \$1,000 management service fee.

| | | |
|--|----|--------|
| Management/Operation Fee | \$ | 1,000 |
| Plus: Discharge Analysis Fee | + | 130 |
| Monthly Revenue | \$ | 1,130 |
| Multiplied by: 12-Months | x | 12 |
| Annual Management-Testing Expense | \$ | 13,560 |
| Less: Reported Routine Maintenance Fee | - | 8,590 |
| Pro Forma Adjustment | \$ | 4,970 |

j. Depreciation Expense:

The original plant should have been fully depreciated in 2005; therefore the associated depreciation expense has been removed. Also, the capital costs have been depreciated over their useful lives.

| | Expenditure | Depreciation | |
|---------------------------------|-------------|--------------|----------|
| | | Life | Expense |
| Installed Used Blower | \$ 1,362.78 | 10 | \$ 136 |
| Installed used blower motor | \$ 633.48 | 10 | 63 |
| New Diffusers | \$ 1,089.91 | 20 | 54 |
| Plant Fully Depreciated in 2005 | | | + (511) |
| Pro Forma Adjustment | | | \$ (258) |

k. Amortization Expense:

The non-recurring costs have been amortized over their useful lives.

| | Expenditure | Amortization | |
|----------------------|-------------|--------------|----------|
| | | Life | Expense |
| CCTV & Root Cutting | \$ 2,982 | 20 | \$ 149 |
| Cleaning the Creek | \$ 1,500 | 5 | 300 |
| Legal Fees | \$ 4,391 | 6 | + 732 |
| Pro Forma Adjustment | | | \$ 1,181 |

APPENDIX B
STAFF REPORT CASE NO. 2008-00042
STAFF'S REVISED
PRO FORMA OPERATIONS

| Account Titles | Cedarbrook Pro Forma Operations | Revised Pro Forma Adjustments | Ref. | Staff Revised Pro Forma Operations |
|---------------------------------|---------------------------------------|-------------------------------------|------|--|
| Operating Revenues: | | | | |
| Residential | \$ 14,412 | \$ 0 | | \$ 14,412 |
| Misc. Operating Revenues | 411 | 0 | | 411 |
| Total Operating Revenues | <u>\$ 14,823</u> | <u>\$ 0</u> | | <u>\$ 14,823</u> |
| Operating Expenses: | | | | |
| Operation & Maint. Exp: | | | | |
| Owner/Manager Fee | \$ 0 | \$ 3,600 | (a) | \$ 3,600 |
| Sludge Hauling | 1,329 | 0 | | 1,329 |
| Utility Service - Water | 408 | 0 | | 408 |
| Testing/Analysis of Effluent | 1,896 | 0 | | 1,896 |
| Electricity | 2,879 | 0 | | 2,879 |
| Chemicals | 1,158 | 0 | | 1,158 |
| Misc Sup & Exp - Treat. & Disp. | 0 | 0 | | 0 |
| Routine Maintenance Fee | 8,712 | 0 | | 8,712 |
| Maintenance | 3,825 | 0 | | 3,825 |
| Office Supplies | 34 | 0 | | 34 |
| Outside Services Emp. - Legal | 78 | 0 | | 78 |
| Outside Services Emp. - MGT | 12,000 | (12,000) | (a) | 0 |
| Total Operation & Maint. Exp. | <u>\$ 32,319</u> | <u>\$ (8,400)</u> | | <u>\$ 23,919</u> |
| Depreciation | 254 | 0 | | 254 |
| Amortization | 1,181 | 0 | | 1,181 |
| Taxes Other than Income Tax | 107 | 0 | | 107 |
| Total Operating Expenses | <u>\$ 33,861</u> | <u>\$ (8,400)</u> | | <u>\$ 25,461</u> |
| Net Operating Income | <u>\$ (19,038)</u> | <u>\$ 8,400</u> | | <u>\$ (10,638)</u> |
| Other Income: | | | | |
| Interest Dividend Income | 130 | 0 | | 130 |
| Net Income | <u><u>\$ (18,908)</u></u> | <u><u>\$ 8,400</u></u> | | <u><u>\$ (10,508)</u></u> |

a. Management and Owner/Manager Fees:

In the test period, Cedarbrook paid Covered Bridge Utilities a monthly managerial fee of \$1,000. The contract between Cedarbrook and Covered Bridge Utilities was negotiated between two unaffiliated companies. Covered Bridge and Cedarbrook Utilities, LLC have common ownership, Marty Cogan and Larry Smither. Therefore, if the proposed transfer is approved the compensation paid to Mr. Cogan and Mr. Smither for their management duties will become a less-than-arms-length transaction. At that time Mr. Smither and Mr. Cogan will be entitled to be compensated for their managerial services and will be at liberty to share in any profits from the utility operations.

In a case involving a sewer of comparable size to Cedarbrook the Commission stated that “[w]hile an owner/manager is responsible for overseeing the daily operations of the system and monitoring the ongoing litigation, for a small sewer system such as Shadow Wood that does not constitute full-time employment.”² In that preceding the utility did not present any convincing evidence to suggest that its operations differ significantly from those of others to require greater administrative oversight and a larger administrative salary. The Commission found that an, owner/manager fee of \$3,600 is consistent with the level of expense awarded other small, privately owned sewer treatment utilities, in that \$3,600 is a reasonable and adequate level of compensation for all appropriate duties performed by management in a normal year of operations.

Since the transfer has yet to be approved there is no documentation to show that Cedarbrook will require greater administrative oversight to support an owner/manager fee larger than the \$3,600 fee the Commission has determined reasonable and adequate. Accordingly, Staff is eliminating the \$12,000 management fee from Cedarbrook’s pro forma operations and replacing it with a \$3,600 owner/manager fee.

² Case No. 2001-00423, The Application of Shadow Wood Subdivision Sewer Service, A Joint Venture of Fourth Avenue Corporation and Long Corporation D/B/A Shadow Wood Subdivision Sewer Service for an Adjustment of Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities, (Ky. PSC September 6, 2002).

APPENDIX C
STAFF REPORT CASE NO. 2008-00042
REVENUE REQUIREMENT
AND RATE DETERMINATION

Operating Ratio Determination

| | Cedarbrook Pro Forma | Staff Pro Forma |
|--------------------------------|-------------------------|--------------------|
| Operating Revenues | \$ 14,823 | \$ 14,823 |
| Divided by: Operating Expenses | ÷ 33,861 | ÷ 25,461 |
| Operating Ratio | <u>43.776%</u> | <u>58.218%</u> |

Revenue Requirement Determination

| | | |
|--|------------------|------------------|
| Operating Expenses | \$ 33,861 | \$ 25,461 |
| Divided by: Operating Ratio | ÷ 88% | ÷ 88% |
| Requested Revenue Requirement | \$ 38,478 | \$ 28,933 |
| Less: Interest Income | <u>130</u> | <u>130</u> |
| Requested Revenue Requirement - Operations | \$ 38,348 | \$ 28,803 |
| Less: Misc. Operating Revenues | <u>411</u> | <u>411</u> |
| Revenue Requirement - Sewer Rates | \$ 37,937 | \$ 28,392 |
| Less: Normalized Operating Revenue | <u>14,412</u> | <u>14,412</u> |
| Requested Increase in Revenue from Rates | <u>\$ 23,525</u> | <u>\$ 13,980</u> |
| Percentage Increase | <u>163.232%</u> | <u>97.002%</u> |

Rate Determination

| | | |
|--|-----------------|-----------------|
| Requested Revenue Requirement | \$ 37,937 | \$ 28,392 |
| Divided by: 12-Months | <u>12</u> | <u>12</u> |
| Monthly Requested Revenue Requirement | \$ 3,161.40 | \$ 2,366.00 |
| Divided by: End-of-Period Customer Level | <u>51.0</u> | <u>51.0</u> |
| Monthly Rate per Customer | <u>\$ 62.00</u> | <u>\$ 46.40</u> |