COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF BIG BEAR WASTEWATER, INC. FOR AN ADJUSTMENT OF RATES	))	CASE NO. 2009-00171

ORDER

On April 28, 2009, Big Bear Wastewater, Inc. ("Big Bear") filed with the Commission an Alternative Rate Filing ("ARF") for an adjustment of rates. In that filing, Big Bear listed the effective date of the proposed tariff as May 30, 2009. Pursuant to KRS 278.190(2), the Commission suspended the proposed rates for five months until October 30, 2009. On October 9, 2009, Big Bear notified the Commission that, pending a final decision in this matter, Big Bear had elected to place the proposed rates in effect as of October 30, 2009. In that circumstance, the utility is required to maintain its records in a manner that will enable it or the Commission to determine any amounts to be refunded to customers if the rates placed in effect are found to be unreasonable.

Commission Staff has prepared the attached report containing its findings and recommendations regarding the proposed rates. All parties should review the report carefully and submit any written comments regarding Staff's findings and recommendations or requests for a hearing as set out in the procedural schedule.

IT IS THEREFORE ORDERED that:

1. Any parties requesting a formal hearing in this matter shall state in its request its objections to the findings set forth in the Staff Report and provide a brief summary of testimony that it would present at a hearing.

2. A party's failure to object to a finding or recommendation contained in the Staff Report within the time set by the procedural schedule shall be deemed as agreement with that finding or recommendation.

3. If no request for a hearing or an informal conference is received within the time set in the procedural schedule, this case shall stand submitted to the Commission for decision.

By the Commission

ENTERED
JAN 22 2010
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

Richard G. Raff for

Executive Director

STAFF REPORT

ON

BIG BEAR WASTEWATER, INC.

CASE 2009-00171

On April 28, 2009, Big Bear Wastewater Inc. ("Big Bear") filed its application seeking to increase its rates for sewer service pursuant to Administrative Regulation 807 KAR 5:076. Big Bear's current flat monthly rate is $30.37 to each customer receiving sewer service. Big Bear proposed to increase this rate in three phases. The phase I rate would be $45.95/mo, a 51.3 percent increase; after the first year, the phase II rate would be $49.93/mo, a 64.38 percent increase; and after the second year, the phase III rate would be $53.90/mo, for a total increase in the current rate of 77.5 percent. According to the information provided in Big Bear's application, the three phase rate increase will produce a total increase in revenues of $24,094.

The test year upon which the application was based was the calendar year ended December 31, 2007. However, at the time Big Bear filed its application in this case, its 2008 financial statements had already been submitted to the Commission as part of its 2008 annual report. Big Bear did not state any reason for using 2007 as the test year in its application instead of 2008. Staff is of the opinion that the 2008 financial statements better represent Big Bear's current operations and recommends that the Commission use 2008 as the test year upon which to determine Big Bear's revenue requirement. Following this recommendation, Staff performed a limited financial review of Big Bear's operations for the 12 months ended December 31, 2008 to determine the reasonableness of Big Bear's requested rate increase.

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.

Daryl Parks, Dennis Jones, and Eddie Beavers of the Commission's Financial Analysis Division performed the limited review. This report summarizes Staff's findings and recommendations resulting from their review. Mr. Parks and Mr. Jones are responsible for all areas of this report concerning revenue requirements while Mr. Beavers is responsible for normalized revenues and rate design.

Appendix A of this report details Big Bear's reported test year operations and Staff's adjustments thereto for known and measurable changes as allowed by Administrative Regulation 807 KAR 5:001, Section 10(7). Appendix B provides a detailed calculation of Big Bear's revenue requirement as determined by Staff. Appendix C provides the breakdown of the 3 year phase in of the recommended sewer rates as determined by Staff.

As shown in Appendix B, Staff has calculated Big Bear's revenue requirement to be $52,563 requiring an increase of $21,100 or approximately 67.1 percent over normalized test year revenues from rates of $31,463. The determination of the recommended rate of $50.74 per month is shown in Appendix B. This rate would increase a customer's monthly bill from $30.37 to $50.74, an increase of $20.37 or approximately 67.1 percent.

As the rate necessary to generate the $52,563 revenue requirement is a large increase and Staff agrees with Big Bear's desire to lessen the rate shock to its customers, Staff agrees with utilizing a phased in rate. Staff differs with Big Bear on the implementation of the phased in rate, Staff recommends the phased in rate should occur in three phases but at an increase that equals a $6.79 increase in the monthly rate over a three year period. As shown in Appendix C, the rates for the successive years will be increased from the current rate of $30.37 to the $50.74.

Signatures:

Dennis Jones

Prepared by: Dennis Jones
Branch Manager, Water Revenue Requirements Branch, Division of Financial Analysis

Daryl Parks

Prepared by: Daryl Parks
Public Utilities Financial Analyst III, Water Revenue Requirements Branch, Division of Financial Analysis

Eddie Beavers

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

APPENDIX A
STAFF REPORT CASE NO. 2009-00171
STAFF'S ADJUSTED OPERATIONS

	Proposed Test Year	Adjustment	Ref.	Pro forma
Operating Revenues	$ 33,498	(2,035)	A	$ 31,463
Operating Expenses				
Operation and Maintenance Expenses				
Owner/Manager Fee	6,000	(2,400)	B	3.600
Collect. Sys. Labor, Materials and Exp.	3,226	(3,226)	C	0
Sludge Hauling	1,993	0	D	1,993
Utility Cost – Water	479	(479)	E	0
Chemicals Expense	2,081	0	F	2,081
Routine Maintenance Fee	0	13,200	G	13,200
Maintenance of Collection Sewer	1,575	(1,575)	H	0
Admin. And General Salaries	2,700	0	I	2,700
Office Supplies and Expense	7.363	0	J	7,363
Chemical Testing	1,029	483	K	1,512
Insurance	967	239	L	1,206
Employee Pensions and Benefits	2,488	(2,488)	M	0
Rents & Leases	2,400	(1,200)	N	1,200
Miscellaneous	461			461
Over Head	6,257	0		6,257
Total Operation and Maint. Expenses	39,019	2,554		41,573
Depreciation	7,608	(6,988)	O	620
Amortization		725	P	725
Taxes Other than Income	1,982			1,982
Total Operating Expenses	48,609	(3,709)		44,900
Utility Operating Income	(15,111)	1,674		(13,437)
Income Available to Service Debt	$ (15,111)	1,674		$ (13,247)

A) Normalized Revenue. Big Bear's 2008 annual report stated operating revenues from rates as $33,498. This amount includes two payments for service that were recorded in December 2008 from Big Bear Resort (Resort), the Dens Condominiums Association and the Treetops Condominiums Association. This resulted in 13 monthly payments from these entities being recorded in Big Bear's test year operations. After reviewing Big Bear's 2008 financial statements, Staff has determined that the extra payment recorded in December 2008 should have been recorded in

January 2009. Removing this extra payment reduces test year operating revenue by $2,035 to $31,463.

Test Year Revenue		$ 33,498
Less: Extra payment		
Big Bear Resort	(486)	
The Dens Condominium	(820)	
Treetops Condominiums	(729)	
Total Extra payments		(2,035)
Pro Forma Operating Revenue		$ 31,463

B) Owner/Manager Fees. In its application, Big Bear recorded the Owner/Manager fee of Mr. Meier as a Consultant Fee. Big Bear proposed to increase this fee from $3,600 to $6,000.

In order to justify this expense, on January 8, 2010, Staff issued an information request to Big Bear seeking documentation on the job duties and amount of time required to perform those duties for the Owner/Manager. Big Bear provided a list of the duties and responsibilities for Mr. Meier. However, Big Bear could not track the amount of hours spent performing these duties saying it is a full-time responsibility. Since Big Bear's Owner/Manager fee is not the result of an arm's-length transaction, Big Bear must demonstrate by substantial evidence that the fee is reasonable. Big Bear has failed to provide any information that the Owner/Manager duties have in any way changed or increased. There is no showing of how much time the Owner/Manager devotes to theses duties or that they require more time or effort than in the past.

Big Bear notes Case No. 2007-00436, as justification for the $6,000 fee. Again, the reasonableness of the fee will depend on the circumstances of the particular utility; its owner's responsibilities and duties and the size and complexity of the sewer utilities operations. With a utility as small as Big Bear and given the fact that Staff has approved of the hiring of a contractor to perform routine maintenance, Staff considers the Owner/Manager fee of $3,600 to be adequate compensation for overseeing daily operations of the utility. Lacking any justification for increasing these expenses, Staff has kept this expense at $3,600. The result of the above adjustment is a reduction of $2,400 in the test year for Consultant Fees.

C) Collection System Labor, Materials and Expenses. Big Bear stated in the application that the $3,226 labor cost allocation in this account included in its 2007 Annual Report was being removed and any adjustments to labor costs would be requested under the Routine Maintenance Fee Expenses and other accounts.

D) Sludge Hauling Expense. Big Bear proposes using the 2008 sludge hauling expense of $3,200 instead of the 2007 expense of $1,992.67. Based on the Annual Report filed with the Commission, Staff agrees with the amount of the 2008 expense. Since 2008 was used as a test year, no adjustment was made to the Total Operating Expenses.

E) Utility Cost -- Water Cost. In its application, Big Bear noted that it had not been recording water expenses. The Resort has notified Big Bear that it intends to begin charging $39.90 a month, the minimum charge for a 2-inch meter connection from North Marshall Water District, for Big Bear's portion of this expense. In an information request, dated January 8, 2010, Staff asked for supporting documentation in the form of a water bill to see if the amount that the Resort wants to charge is reasonable. Big Bear and the Resort share the same water line, thus, their usage is combined into one bill. Big Bear did not provide a copy of the water bill for Staff to examine. Big Bear's only supporting documentation was the cost of a customer charge that it would incur if it had a separate 2-inch meter from the Resort. Due to the fact that Big Bear is not separately metered by the North Marshall Water District, Staff does not feel that this charge is reasonable or justified. Given that this would be a less than arms-length transaction and due to the lack of supporting documentation; Staff has not made this adjustment to test year operating expenses.

F) Chemical Expenses. In its 2007 annual report, chemical charges of $2,081 were recorded in Maintenance of Collection Sewer System Expenses. Big Bear proposes moving this amount to Chemicals Expense in 2008. Staff agrees with this adjustment.

G) Routine Maintenance Fees Expense. In the application, Big Bear states the need to hire an outside contractor to perform routine maintenance. Big Bear proposes a fee of $13,200 based on a bid submitted by an outside contractor. The bid is broken down as follows: $300 per week for the 36-week seasonal period when the resort experiences heavy use and $150 per week for the 16-week period of reduced operation. Big Bear also provided a sample contract listing the duties and responsibilities of the contractor. Based on the information provided, Staff agrees with this adjustment.

H) Maintenance of Collection Sewer System Expense. Big Bear notes that for 2008 the sludge hauling expense and chemical expenses have been removed from this account and reassigned. Staff agrees with this adjustment and is further of the opinion that the remaining $1,575 represents routine maintenance and has eliminated this amount as well.

I) Administrative and General Salaries. In its application, Big Bear recorded the salary of the Vice-President, Ms. Caldemeyer, as a Consultant Fee. Big Bear proposed to increase her salary from $2,700 to $3,600.

In order to justify this expense, on January 8, 2010, Staff issued an information request to Big Bear seeking documentation on the job duties and amount of time required to perform those duties for the Vice-President. Big Bear provided a list of the duties and responsibilities for Ms. Caldemeyer. However, Big Bear could not track the amount of hours spent performing these duties saying it is a full-time responsibility. Since the salary of the Vice President is not the result of an arm's-length transaction, Big Bear must demonstrate by substantial evidence that the fee is reasonable. Big Bear has failed to provide any information that the Vice President's duties have in any way changed or increased. There is no showing of how much time the Vice President devotes to theses duties or that they require more time or effort than in the past.

Lacking any justification for increasing this expense, Staff has kept this expense at $2,700.

J) Office supplies and Expenses. In the application, Big Bear requested a pro forma amount of $200 for postal expenses stating that it has not paid its share of this cost. Big Bear spent $23.70 for postal expenses in 2007 and $47.03 in 2008. Through the first 8 months of 2009, the postal expenses totaled $39.01. Staff is of the opinion that the historical levels of this expense do not adequately justify the $200 requested. Therefore, Staff has not made any pro forma adjustment for this increase.

K) Chemical Testing. Big Bear currently pays $126 per month to McCoy & McCoy for water testing. This results in normalized test year expense of $1,512, a $483 increase over the test year expense $1,029. Therefore, chemical testing expense has been increased by $483.

Current monthly water testing fee	$	126
Total months	X	12
Pro forma water testing expense		1,512
Pro forma water testing expense		1,512
Water testing expense for 2008		(1,029)
Increase in yearly testing fees	$	483

L) <u>Insurance</u>. In its application, Big Bear stated that it failed to include annual liability insurance of $967 in its 2007 financial statements. This amount was recorded in 2008. Since Staff is using 2008 as its test year in this preceding no pro forma adjustment to include this item is needed.

Big Bear's current cost for workers comp insurance is $3.80 per $100 of labor cost. The total pro forma labor cost for the test period is $6,300. This results in worker's comp expense of $239. Therefore, Staff has increased worker's comp expense by $239.

Labor cost for 2008	$	6,300
Factor used in determining cost of workers comp insurance		0.038
Pro forma cost of workers comp insurance	$	239

M) <u>Employee Pensions and Benefits Expense.</u> Labor charges of $2,488 were allocated to this account in 2007. Big Bear proposes removing this charge and having appropriate compensation for the removed labor costs to be requested in Routine Maintenance Fees. Staff agrees with this adjustment.

N) Office Rent. During the test year, Big Bear reported office rental expense of $1,200 for office space that it shares with the Resort. The Resort has informed Big Bear that it intends to start charging a monthly fee of $200 per month for office rent making the total annual expense for office rental $2,400. Office rent paid by Big Bear to the Resort represents a less than arms-length transaction since both entities are wholly owned by Ms Caldemeyer. Big Bear did not provide any documentation justifying the need for or the amount of this expense. Therefore, given the nature of this transaction and the lack of supporting documentation, Staff has not included this increase in pro forma operations.

O) Depreciation. For the test year, Big Bear used an accelerated method of depreciation. For rate-making purposes, the straight-line method of depreciation is used by this Commission to evenly spread the expense over the useful life of the depreciable asset. In Case No. 1999-00114, the Commission excluded depreciation on existing plant stating that "...the plant was or should have been recovered by Big Bear Resort's developer, Big Bear, Inc. through the sale of condominiums and special assessments... Big Bear Development's cost recovery is considered a contribution in aid of construction and should be recorded on the books of the entity currently operating the plant in account 271-contributions in aid of construction." Therefore, Staff has excluded depreciation on this plant in its revenue requirement calculation. Staff also increased the useful life of a de-chlorinator to 10 years as opposed to the 7 years listed on Big Bear's depreciation schedule. These changes in depreciation result in a decrease of $6,988 from the test year expense of $7,608.

Big Bear also requested depreciation expense for projects that were not completed as of the filing of the application. Staff has not included depreciation on these projects in its pro forma operations.

Declorinator		
Cost	$	2,439
Total Depreciation as of 12/31/08		1,582
Remaining amount left to be depreciated		857
Years left to depreciated		6
Pro forma depreciation	$	143
Grinder/macerator pump		
Cost	$	2,682
Total Depreciation as of 12/31/08		1,040
Remaining amount left to be depreciated		1,642
Years left to depreciated		5
Pro forma depreciation	$	328
Lift Station Sump Pump		
Cost	$	1,851
Total Depreciation as of 12/31/08		959
Remaining amount left to be depreciated		892
Years left to depreciated		6
Pro forma depreciation	$	149
Total pro forma depreciation for 2009	$	620

P) Amortization. In the application, Big Bear proposed that the expenses related to the rate case be amortized over three years and the KPDES permit fee be amortized over five years. Big Bear states that its rate case expense is $1,575 and its KPDES permit fee is $1,000. Amortized over three years, the rate case expense is $525 per year and the KPDES permit fee is $200 per year. Staff agrees with this adjustment.

Q) Interest Expense. Test year interest expenses on long-term debt were $10,296, which is from the sale of the sewer plant and building to Big Bear in 1998. In

Case No. 99-114, the Commission stated that, "Big Bear, the Resort, and the Development are all related parties..." and that "... no interest expense stemming from the sale of this plant between these related parties should ever be included in revenue requirements. The interest was created through a series of related party transactions that wasn't necessary. Since the stockholders of the Development and Big Bear are the same the interest charges could have been avoided if the capital to purchase the plant had been initially invested in Big Bear instead of the Development." Therefore, given this previous finding by the Commission, interest expense has not been included in the determination of Big Bear's revenue requirement.

APPENDIX B
STAFF REPORT CASE NO. 2009-00171
CALCULATION OF REVENUE REQUIREMENT AND RECOMMENDED RATE

Pro forma operating expenses before taxes	$	44,900
Divide by: Operating ratio		88%
Total revenue required before taxes		51,023
Less: Pro forma operating expenses before taxes		(44,900)
Net income allowed after taxes		6,123
Multiply by: Tax gross up Factor		1.251564456
Net operating income before taxes		7,663
Plus: Operating expenses before taxes		44,900
Revenue requirement	$	52,563
Revenue		100.00000%
Less: Sales tax		6.00000%
Sub-total		94.00000%
Less: Federal tax, 15% of sub-total		14.10000%
Percent change in NOI		79.90000%
Revenue conversion factor (Revenue of 1 divided by percent change in NOI)		125.15645%

Revenue Requirement	$	52,563
Divide by: Pro forma number of bills, (96x8)+(67x4)		1,036
Recommended Rate	$	50.74

APPENDIX C
STAFF REPORT, CASE NO. 2009-00171
STAFF'S RECOMMENDED SEWER RATES

RATES AND CHARGES

Monthly Charge Year 1	$37.16
Monthly Charge Year 2	$43.95
Monthly Charge Year 3	$50.74

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