

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ALTERNATIVE RATE FILING OF) CASE NO.
COOLBROOK UTILITIES, LLC) 2010-00314

ORDER

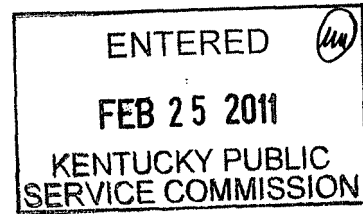
On August 4, 2010, Coolbrook Utilities, LLC ("Coolbrook") filed its application for Commission approval of proposed sewer rates. Staff has prepared the attached report containing its findings and recommendations regarding the proposed rates. All parties should review the report carefully and submit any written comments about Commission Staff's findings and recommendations or requests for a hearing or an informal conference no later than 14 days from the date of this Order.

IT IS HEREBY ORDERED that:

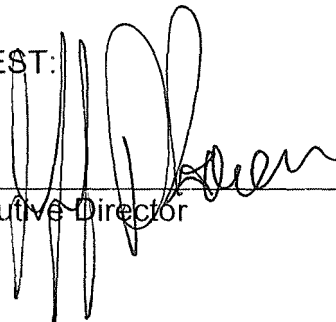
1. All parties shall have 14 days from the date of this Order to file with the Commission written comments, if any, regarding the attached Staff Report and to request a hearing or an informal conference in this matter.
2. Any party requesting a hearing in this matter shall state in its request its objections to the findings set forth in the Staff Report and shall provide a brief summary of testimony that it would present at hearing.
3. A party's failure to file with the Commission an objection to a finding or recommendation contained in the Staff Report within 14 days of the date of this Order shall be deemed as agreement with that finding or recommendation.

4. 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.

By the Commission



ATTEST:



Executive Director

STAFF REPORT
ON
COOLBROOK UTILITIES, LLC
CASE NO. 2010-00314

On August 4, 2010, Coolbrook Utilities, LLC ("Coolbrook") filed its application seeking to increase its rates for sewer service pursuant to 807 KAR 5:076. The test year upon which the application is based is the calendar year ending December 31, 2009. Coolbrook's current flat monthly rate is \$22.22 to each customer receiving sewer service. Coolbrook proposes to increase this rate 57.5 percent, to \$35.00. According to the information provided in Coolbrook's application, the proposed rate will produce revenues of \$182,700.

On September 2, 2010, Sam Bryant and Eddie Beavers of the Commission's Staff ("Staff") performed a limited review of Coolbrook's test-year operations to determine the reasonableness of the application. This review was supplemented with information obtained through several subsequent discovery requests. The scope of Staff's review was limited to obtaining information as to whether the test-year operating revenues and expenses are representative of normal operations and Coolbrook's proposed adjustments are reasonable. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

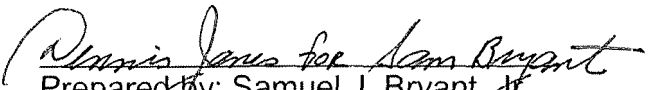
This report summarizes Staff's findings and recommendations resulting from its review. Mr. Bryant is responsible for all areas of this report concerning revenue requirements. Mr. Beavers is responsible for normalized revenues and rate design.


Attachment A of this report details Coolbrook's reported test-year operations and Staff's adjustments thereto and includes narrative explanations for all test-year adjustments proposed by Staff. Attachment B includes a calculation of the revenue requirement.

Staff's adjusted pro forma operations produce a revenue requirement of \$155,265 and a flat monthly rate of \$29.74, a 33.8% increase over the current flat monthly rate of \$22.22.

Attachment C to this report shows the rate Staff recommends that will produce the revenue requirement calculated at Attachment B.

Signatures:


Prepared by: Samuel J. Bryant, Jr.
Financial Analyst, Water and Sewer
Revenue Requirement Branch
Division of Financial Analysis


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

ATTACHMENT A
STAFF REPORT 2010-00314
REQUESTED AND RECOMMENDED
PRO FORMA INCOME STATEMENTS

	2009 Annual Report	Coolbrook		Staff	
		Pro Forma Adjustments	Pro Forma Operations	Pro Forma Adjustments	Pro Forma Operations
Operating Revenues:					
Revenues - Residential	\$ 117,369	\$ (1,381) A	\$ 115,988	\$ 0	\$ 115,988
Operating Expenses:					
Owner/Manager Fee	\$ 2,800	\$ 6,800	\$ 9,600	\$ (6,000) B	\$ 3,600
Sludge Hauling	7,085	0	7,085	0	7,085
Water	370	0	370	0	370
Other Labor, Materials	10,556	0	10,556	0	10,556
Fuel & Power Expense	22,588	1,548 C	24,136	0	24,136
Chemicals	6,192	0	6,192	0	6,192
Routine Maintenance Fee	17,600	1,600 D	19,200	0	19,200
Maintenance of Collection Sys.	1,850	0	1,850	0	1,850
Maintenance of Treat. & Disp.	17,751	0	17,751	0	17,751
Maintenance of Other Plant	7,764	0	7,764	0	7,764
Agency Collection Fee	17,605	9,800	27,405	(9,800) E	17,605
Office Supplies and Other	1,269	0	1,269	0	1,269
Outside Services Employed	4,368	0	4,368	0	4,368
Insurance Expense	1,000	5,689	6,689	(5,689) F	1,000
Misc. General Expense	250	0	250	0	250
Rent	0	1,200	1,200	0 G	1,200
Total O&M Expenses	\$ 119,048	\$ 26,637	\$ 145,685	\$ (21,489)	\$ 124,196
Depreciation Expense	6,075	5,687	11,762	(8,416) H	3,346
Amortization Expense	0	5,667	5,667	(5,000) I	667
Taxes Other Than Income	3,680	740 J	4,420	0	4,420
Total Operating Expenses	\$ 128,803	\$ 38,731	\$ 167,534	\$ (34,905)	\$ 132,629
Net Operating Income	\$ (11,434)	\$ (40,112)	\$ (51,546)	\$ 34,905	\$ (16,641)
Interest on Long-term Debt	2,049	0	2,049	(2,049) K	0
Other Interest Expense	1,572	242	1,814	(1,814) L	0
Net Income	(15,055)	(\$40,354)	(\$55,409)	\$38,768	(\$16,641)

A. Revenues were adjusted for normalization by Coolbrook. Coolbrook reported 435 customers receiving sewer service. Coolbrook reported test-year revenues of \$117,369. Therefore, test-year revenues are decreased by \$1,381 to \$115,988.

Present Flat Rate	\$ 22.22
Times: Number of Customers	435
Times: 12 Months	<u>x 12</u>
Pro forma	\$ 115,988
Less: Test Year	<u>\$ 117,369</u>
Decrease	<u>\$ 1,381</u>

B. Owner/Manager Fee. Coolbrook proposes an owner/manager fee of \$9,600 in this case. The Commission generally allows an owner/manager fee of \$3,600 to compensate the owner/manager of a sewer utility. Coolbrook notes that, in Case No. 2007-00436,¹ this Commission allowed an owner/manager fee of \$6,000 for a smaller-sized sewer utility that is located near Coolbrook.

In its decision in Case No. 2007-00436, the Commission stated that “the reasonableness of the [owner-manager] fee will depend on the circumstances of the particular utility, to include its owner’s responsibilities and duties and the size and complexity of the sewer utility’s operations.”² It further stated that, as the payment of an owner-manager fee is not an arms-length transaction, the utility must demonstrate by substantial evidence that the fee is reasonable.

¹ Case No. 2007-00436, Application of Farmdale Development Corporation for an Adjustment in Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities, at 6 (Ky. PSC Jul. 30, 2008).

² Id. at 6.

Coolbrook has not demonstrated that, given its operations, the proposed fee is reasonable. In this proceeding, Coolbrook asserts that its owners spend five hours per week, or 250 hours annually, managing the operations of Coolbrook, but fails to present any documentary evidence to show the amount of time that they devote to utility operations. Based upon its application, Coolbrook contracts most operational duties to third parties. Given the limited demands placed upon its owners as a result of its significant use of contractors and the absence of any special or unusual duties or functions performed by Coolbrook's owners, Commission Staff finds insufficient evidence to support the proposed fee of \$9,600.

Commission Staff further notes that, in the most recent proceedings involving similarly-sized sewage treatment facilities,³ the Commission has found \$3,600 to be a reasonable level of expense for the owner/manager fee. In the absence of any factor that distinguishes Coolbrook's operations from those entities or the duties that Coolbrook's owners perform from those other utility owners, it recommends that the Commission use the same level of expense in this case.

C. Fuel and Power Expense. Coolbrook proposed a total of \$24,136, an increase of \$1,548 over actual test-period expense. The increase was to normalize the

³ Case No. 2007-00443, South 641 Sewer District (Ky. PSC Dec. 20, 2007); Case No. 2008-00042, Cedarbrook Treatment Plant (Ky. PSC Jul. 29, 2008); Case No. 2008-00355, Thomas Country Estates Wastewater Treatment Plant (Ky. PSC Oct. 24, 2008); Case No. 2008-00482, Purchase Public Service Corporation d/b/a Great Oaks Subdivision (Ky. PSC Mar. 24, 2007); Case No. 2008-00501, Ledbetter Water District (Ky. PSC May 22, 2009); Case No. 2008-00506, Powell's Valley Water District, Sewer Division (Ky. PSC Apr. 14, 2009); Case No. 2009-00075, Longview Land Company (Ky. PSC Jul. 20, 2009); Case No. 2009-00227, Middletown Waste Disposal, Inc. (Ky. PSC Apr. 30, 2010); Case No. 2009-00403, Evergreen Disposal System, Inc. (Ky. PSC Jul. 29, 2010); Case No. 2010-00231, Purchase Public Service Corporation (Ky. PSC Sept. 9, 2010).

expense for an increase in the rates of Coolbrook's electric supplier—Blue Grass Energy. Staff finds this proposed increase to be reasonable and recommends that it be accepted.

D. Routine Maintenance Fees Expense. Coolbrook proposes to adjust this expense by \$1,600 because the expense had only eleven payments instead of twelve, which would accurately reflect a full year of charges. Staff finds this adjustment to be correct and recommends its acceptance.

E. Agency Collection Fee. Coolbrook reported test-year expenses of \$17,605 for this account. Coolbrook proposes this amount be increased by \$9,800 to \$27,405. This would amount to a 15 percent charge on Coolbrook's proposed revenues of \$182,700. Coolbrook asserts that its current billing and collection arrangement with Farmdale requires the adjustment.

Staff finds the proposed adjustment and Coolbrook's use of Farmdale as a collection agent to be unreasonable. The proposed level of collection fees would amount to a \$5.41 per month charge for each customer and is much higher than that of other jurisdictional utilities around the state.

This Commission has long been concerned with the high cost of Farmdale's billing and collection services. In Case No. 1998-00284,⁴ the Commission reviewed the reasonableness of the fees paid by 4-Way Enterprises and stated:

After reviewing the record the Commission concurs with Staff's recommendation that the billing and collection expense not be increased from the test year level. In addition, it finds that when filing the next application 4-Way should be required to present evidence that its billing

⁴ Case No. 1998-00284, 4-Way Enterprises, Inc., Coolbrook Sanitation Division (Ky. PSC Mar. 25, 1999).

and collection expense is reasonable. Reasonableness may be presumed if 4-Way advertises and receives public bids for its billing and collection.⁵

Coolbrook has not advertised for bids for its billing and collection functions. It advised Commission Staff that, given its negative collection experience with other utilities, it had not advertised for bids nor considered performing the billing and collection activity itself. Coolbrook contends that the competitive bidding process required of Farmdale in Case No. 2007-00436 failed to produce any attractive alternatives to Farmdale's providing these services. Coolbrook further contends that collections are more efficiently and effectively performed by water utilities that may terminate water service if the entire bill including the sewer portion is not paid.

Commission Staff finds that Coolbrook has failed to demonstrate the reasonableness of the proposed amount for Agency Collection Fee and recommends that the proposed fee be denied, that the test period expense of \$17,605 be allowed, and that the Commission direct Coolbrook to aggressively pursue reasonable alternatives.

F. Insurance Expense. Coolbrook proposed to increase this expense by \$5,689, to \$6,689. Coolbrook's reason for the increase is so that general liability premiums would be sufficient based upon the revenues requested in this case. Because the increase is based on estimates, Staff recommends that the increase be denied.

⁵ Case No. 1998-00284, In the Matter of the Application of 4-Way Enterprises, Inc., Coolbrook Sanitation Division for a Rate Adjustment Pursuant to the Alternative Rate Filing for Small Utilities (Ky. PSC Mar. 25, 1999).

G. Rent Expense. Coolbrook proposed \$1,200 for rent expense for the test year. Coolbrook shares office space in a building with other utilities and is charged \$100 per month. This amount covers all costs, such as utilities and other occupancy costs. Staff finds the rent expense in this case to be reasonable and recommends it be accepted.

H. Depreciation Expense. In its application, Coolbrook proposed an adjusted test-period depreciation expense of \$11,762, which includes repairs on capitalized repairs and replacements. In Case No. 2008-00257, Coolbrook acquired Classic Construction, Inc.⁶ As part of that proceeding, the Commission received Coolbrook's filed "Notice of Transfer and Notice of Filing of Adoption Notice, Proposed Journal Entry and Line of Credit Documentation" on November 10, 2008. The following is the journal entry provided by Coolbrook to record the purchase of Classic Construction:

Debit	Utility Plant	\$ 1,132,552.00	
Credit	Utility Plant Acquisition Adjustment		\$ 118,568.00
Credit	Accumulated Provision for Depreciation		542,605.00
Credit	Aid in Contribution		471,379.00

In its 2008 Annual Report on file with the Commission, Classic Construction recorded an ending balance for the following accounts:

Utility Plant	\$ 40.857.00
Accumulated Provision for Depreciation, Depletion and Amortization	<u>12,577.00</u>
Net Utility Plant	28,280.00
Contributions in Aid of Construction	35,423.00

⁶ Case No. 2008-00257, Joint Application of Classic Construction, Inc. and Coolbrook Utilities LLC for Approval of the Transfer of Wastewater Treatment Plant to Coolbrook Utilities LLC (Ky. PSC Oct. 21, 2008).

Based on these two entries, the plant transferred from Classic Construction to Coolbrook has been fully recovered either from accumulated depreciation and/or contributed capital.

In its 2009 Annual Report, Coolbrook reported a beginning balance for utility plant of \$60,000, an ending balance of \$61,000, and accumulated depreciation of \$1,250.00 and \$7,325.00 respectively. Neither its annual report nor the application filed in this proceeding provided any detail as to how these amounts were determined. Therefore, Staff is of the opinion that Coolbrook is not entitled to depreciation on either its beginning or ending utility plant shown in its 2009 Annual Report.

During 2010, Coolbrook performed \$28,436.98 of capital repairs on its utility plant.⁷ These repairs have a useful life of between 7 to 10 years. Using the average life of 8.5 years (7 yrs + 10 yrs. = 17, divided by 2 = 8.5 yrs), Staff has calculated an annual depreciation expense of \$3,346. This results in a reduction in Coolbrook's proforma depreciation expense of \$8,416 ($\$11,762 - \$3,346 = \$8,416$).

I. Amortization Expense. Coolbrook included proposed rate-case expense of \$17,000 in this account. Of this amount, \$2,000 is for accounting fees for the preparation of this case and \$15,000 is for anticipated legal fees. Staff recommends that the \$2,000 accounting fee be allowed but that the legal fees be disallowed because, at the present time, the utility has presented no evidence of incurred legal expenses. Amortized over a three-year period, the accounting fee for the test period is \$667.

⁷ Case No. 2010-00314, Alternative Rate Filing of Coolbrook Utilities, LLC, Colbrook's Proforma – Attachment A, Reference note H (filed Aug. 4, 2010).

J. Taxes Other Than Income. Coolbrook proposes to increase this account by \$740 for its KPDES permit fee of \$3,700. A five-year amortization of this fee is \$740. Staff recommends acceptance of this adjustment.

K. Interest on Long-Term Debt. Coolbrook proposes interest expense of \$2,049 on a loan from Classic Construction. The proceeds of the loan were used to purchase Coolbrook and, therefore, this associated interest should be borne by the owners and not recovered from the rate payers. This interest cannot be charged to the utility. Staff recommends this expense be disallowed.

L. Other interest expense. Coolbrook proposes to recover interest expense of \$1,885 on a two-year note of \$25,250. This loan was for repairs to the plant and for other operating expenses. The Commission generally does not allow debt for these types of expenses because the recovery would constitute retroactive rate-making. Staff recommends this expense be disallowed.

ATTACHMENT B
STAFF REPORT, CASE NO. 2010-00314
REVENUE REQUIREMENT

Pro Forma Operating Expenses Before Taxes	\$	132,629
Divided by Operating Ratio	÷	0.88
Total Revenue Required Before Taxes	\$	150,715
Less: Operating Expenses Before Taxes	-	132,629
Net Income Allowed After Taxes	\$	18,086
Times tax Gross up Factor	x	1.251564456 ¹
NOI Before Taxes	\$	22,636
Plus: Operating Expenses Before Taxes	+	132,629
Revenue Requirement	\$	155,265

¹	Revenue	\$	100.00000
	Less: State Income Tax	-	6.00000
	Subtotal	\$	94.00000
	Less: Federal Income Tax (15% x sub total)	-	14.10000
	Percent Change in NOI		79.90000

Revenue Conversion Factor 1/Percentage Change in NOI		1.25156445600
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ATTACHMENT C
STAFF REPORT, CASE NO. 2010-00314
RECOMMENDED RATE

	RATE	
Monthly Flat Rate		\$ 29.74

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