

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF BUSH GARDENS)	
ENTERPRISES, LLC FOR APPROVAL OF INITIAL)	
SEWER RATES PURSUANT TO THE)	CASE NO.
ALTERNATIVE RATE FILING PROCEDURES FOR)	2015-00306
SMALL UTILITIES AND TARIFF)	

NOTICE OF FILING OF COMMISSION STAFF REPORT

Notice is hereby given that, in accordance with the Commission's Order of December 28, 2015, the attached report containing the findings of Commission Staff regarding the Applicant's proposed rate adjustment has been filed in the record of the above-styled proceeding. Pursuant to the Commission's December 28, 2015 Order, Bush Gardens Enterprises, LLC is required to file written comments regarding the findings in this report no later than January 29, 2015, or 14 days after the filing of this report, whichever occurs earlier.



Jeff Derouen
Executive Director
Public Service Commission
P.O. Box 615
Frankfort, KY 40602

DATED JAN 13 2016

cc: Parties of Record

STAFF REPORT
ON
BUSH GARDENS WATER DISTRICT
CASE NO. 2015-00306

Bush Gardens Enterprises, LLC (“Bush Gardens”), provides wastewater service to eight customers¹ residing in the Bush Gardens Subdivision (“Subdivision”) located in Johnson County, Kentucky.² During the ten years that Bush Gardens has been in operation, it has not received any form of compensation for providing wastewater service to the residents of the Subdivision.³ For this reason, Bush Gardens did not meet the definition of a “utility” as described in KRS 278.010, Section 3(f), and therefore, was not subject to the Commission’s jurisdiction.

On September 8, 2015, Bush Gardens filed an application with the Commission seeking establishment of wastewater service rates, several nonrecurring charges, and a tariff. Bush Gardens’ requested residential rate of \$194.61 per month⁴ will produce annual operating revenues of \$18,683.⁵

Bush Gardens based its requested initial rate on the test year ended December 31, 2014. The financial exhibits shown in Bush Gardens’ application that support the requested initial rate are summarized below in condensed form:

¹ Application, ARF Form-1 July 2014, at 3.

² *Id.*, Proposed Tariff at 1.

³ *Id.*, September 3, 2015 Cover Letter at 1.

⁴ *Id.*, Customer Notice of Proposed Rate Adjustment.

⁵ \$194.61 (Flat Residential Rate) x 8 (Customers) x 12 (Months) = \$18,683.

Pro Forma Operating Expenses
as Presented by Bush Gardens

Operating Expenses:	
Operation & Maint. Exp:	
Owner/Manager Fee	\$ 3,600
Fuel & Power	879
Routine Maintenance Fee	3,900
Insurance	2,882
Office Supplies & Other Expenses	336
Chemicals	1,272
Sludge Hauling	475
Regulatory Commission Expense	440
Maintenance Structures & Improvements	1,240
Total Operation & Maint. Exp.	15,024
Depreciation	1,317
Property Taxes	100
Total Operating Expenses	\$ 16,441

Bush Gardens calculated its requested revenue requirement using the operating ratio method as historically accepted by the Commission.⁶ Pursuant to this method, the allowable revenue requirement is calculated by dividing pro forma operating expenses by 88 percent. Bush Gardens calculated its requested revenue requirement of \$18,683, as shown below:

⁶ An operating ratio measures the difference between operating revenues and operating expenses. It is defined by the following equation.

$$\text{Operating Ratio} = \frac{\text{Operation \& Maintenance Exp. + Depreciation + Taxes}}{\text{Gross Revenues}}$$

The Commission has found that the operating ratio is a reasonable and necessary alternative to the rate of return method for calculating the allowable net operating income ("NOI") for small sewer investor-owned utilities. Specifically, it has found that the rate-of-return method cannot be used because there is "no basis" upon which to determine a rate of return for these utilities, Case No. 95-236, *Application of Thelma Waste Control, Inc. for a Rate Adjustment Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC. Apr. 15, 1996) at 6. Further, it has found that the operating-ratio method is appropriate when plant investment is low and operating expenses are high, Case No. 7982, *Notice of Application of Fern Lake Company* (Ky. PSC. Aug. 27, 1981) at 3.

Revenue Requirement
as Presented by Bush Gardens

Operating Expenses	\$ 16,441
Divided by: Operating Ratio	<u>88%</u>
Total Revenue Requirement	<u>\$ 18,683</u>

To determine the reasonableness of the proposed rates, Staff performed a limited financial review of Bush Gardens' test-year operations. The scope of the review was limited to determining whether operations reported for the test year were representative of normal operations. Known and measurable changes to test-year operations were identified and adjustments were made when their effects were deemed to be material. Insignificant and immaterial discrepancies were not pursued or addressed.

Staff's findings and recommendations are summarized in this report. Mark Frost reviewed the calculation of Bush Gardens' Revenue Requirement. Eddie Beavers reviewed Bush Gardens' calculation of its monthly residential rate, the nonrecurring charges, and the proposed tariff.

Summary of Findings

Based on its review, Commission Staff determined that Bush Gardens' test-year operations support an initial flat rate of \$127.33 per month per customer. Commission Staff's calculations are shown and discussed in the remaining sections of this report.

Pro Forma Operating Statement

Bush Gardens' Pro Forma Operating Statement for the test year ended December 31, 2014, as determined by Commission Staff, appears below:

Account Titles	Test-Year Operations	Pro Forma Adjustments	Ref	Pro Forma Operations
Operating Revenues:				
Residential	\$ 0	\$		\$ 0
Operating Expenses:				
Operation & Maint. Exp:				
Owner/Manager Fee	3,600	(3,600)	A	0
Fuel & Power	879	(64)	B	815
Routine Maintenance Fee	3,900	0		3,900
Insurance	2,882	0		2,882
Office Supplies & Other Expenses	336	0		336
Chemicals	1,272	0		1,272
Sludge Hauling	475	0		475
KPDES Permit Amortization	440	0		440
KPDES Quarterly Testing	0	484	C	484
Maintenance Structures & Improvements	1,240	(1,240)	D	0
Total Operation & Maint. Exp.	15,024	(4,420)		10,604
Depreciation	1,317	(1,164)	E	153
Property Taxes	100	(100)		0
Total Operating Expenses	16,441	(5,684)		10,757
Net Operating Income	\$ (16,441)	\$ 5,684		\$ (10,757)

(A) Owner/Manager Fee. Bush Gardens proposes to include a \$3,600 owner/manager fee in its test-year operating expenses, which it will pay to Lance Bowling, the son of Bush Gardens' sole stockholder.⁷ According to Bush Gardens, Mr. Bowling "oversees the operation of the plant and is responsible for overseeing and contracting any work done on the plant."⁸

While Commission Staff recognizes that in proceedings involving small sewerage treatment facilities, the Commission has determined that a \$3,600 owner/manager fee is reasonable, the Commission has found 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

⁷ Bush Gardens' Responses to Commission Staff's First Request for Information ("Staff's First Request"), Item 6.a.

⁸ *Id.*, Item 6.b.

operations.”⁹ The Commission has recognized that the owner/manager’s responsibilities include the oversight of daily operations and of outside contractors.¹⁰ This oversight responsibility is to ensure that the treatment plant operates and conforms to the appropriate regulatory guidelines.

In instances where it has been shown that the owner/manager has neglected his duties and responsibilities, the Commission has disallowed rate recovery of the owner/manager fee. In a prior proceeding the Commission determined that the owner/manager had neglected his owner/manager duties by “not performing monthly bank reconciliations, maintaining vendor invoices, or keeping a formal receipts and disbursements journal.”¹¹ Further by failing to provide detailed responses to the interrogatories, the owner/manager failed to establish a record to support the requested rate increase.¹² For these reasons Commission Staff found that the owner/manager was not “entitled to any level of compensation.”¹³

In this instant case, Commission Staff finds that Bush Gardens’ management has been negligent, and the evidence in the record does not provide support for the recovery of an owner/manager fee. Additionally, Commission Staff notes that the owner/manager failed to present evidence documenting the number of hours that he

⁹ Case No. 2007-00436, *Application of Farmdale Development Corporation for an Adjustment in Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC July 30, 2008) at 6–7.

¹⁰ Case No. 2005-00235, *Application of Mallard Point Disposal System, Inc. for an Adjustment of Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC Apr. 17, 2006), Final Order at 10.

¹¹ Case No. 2003-00284, *Application of Mallard Point Disposal System, Inc. for an Adjustment of Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC Nov. 21, 2003), Commission Staff Report, Attachment C at 4.

¹² *Id.*

¹³ *Id.*

spent performing the daily oversight duties.¹⁴ Bush Gardens stated that if its rate request is approved, Mr. Bowling's full-time job will be spent collecting delinquent accounts.¹⁵ However, Bush Gardens does not demonstrate that the estimate of time necessary to collect delinquent accounts is reasonable. Accepting Bush Gardens' representation that Mr. Bowling plans to dedicate the full amount of his time to collections, the evidence suggests that oversight of the daily operations of the treatment plant will be minimal.

Further support for Commission Staff's position is that Bush Gardens has received five separate Notice of Violations from the Kentucky Department for Environmental Protection in the years 2005,¹⁶ 2007,¹⁷ 2012,¹⁸ and again in 2015.¹⁹ Given the stockholder's and Mr. Bowling's neglect of their owner/manager duties, Commission Staff finds that Bush Gardens has failed to establish that it is performing services that justify its requested \$3,600 owner/manager fee.

¹⁴ Bush Gardens' Responses to Staff's First Request, Item 6.c.

¹⁵ *Id.*, Item 6.c(2).

¹⁶ *Id.*, Item 5.d., February 7, 2005 Notice of Violation. The facility was not being operated at the time of the inspection. The disinfection units were not being properly maintained. Effluent was causing degradation of the waters of the Commonwealth.

¹⁷ *Id.*, Item 5.d., July 24, 2007 Notice of Violation. The skimmer was not operating, allowing excessive solids to accumulate in the clarifier. Excessive solids were present in the disinfection chamber. Weeds were growing in the disinfection chamber and aeration basin.

¹⁸ *Id.*, December 10, 2012 Notice of Violation. Bush Gardens was cited for four separate violations of its Kentucky Pollutant Discharge Elimination System ("KPDES") Permit for discharging pollutants into the water of the Commonwealth.

¹⁹ *Id.*, June 25, 2015 Notice of Violation. The facility is not being properly operated and maintained as required. At the time of the inspection the facility was operating. The aeration basin was aerating. The basin appeared light in color and appeared to be underloaded. The clarifier was being aerated due to an air line leak leading to the skimmer. The clarifier was not able to function properly due to the mixing caused by the air leak. Solids were settling out in the chlorine contact chamber. The discharge pipe for the plant has been broken. The plant now discharges onto the ground near the plant. The effluent is ponding and causing the area to stand in water.

(B) Fuel and Power. Bush Gardens reported electric expense of \$879 for the test year. Bush Gardens did not maintain the copies of the individual monthly invoices that it had received from the Big Sandy Rural Electric Cooperative Corporation (“Big Sandy RECC”). However, Big Sandy RECC did provide to Bush Gardens an analysis of its account activity for the period of March 1, 2013, through November 1, 2015.²⁰ Upon review of the account analysis provided by Big Sandy RECC, Commission Staff determined that the actual cost of electricity for the calendar year 2014 was \$815, which is \$64 below the amount reported by Bush Gardens. Accordingly, fuel and power expense has been decreased by \$64.

(C) KPDES Testing. The KPDES permit requires Bush Gardens to perform quarterly testing of its effluent. In reviewing the test-year invoices, Commission Staff noted that Bush Gardens paid McCoy and McCoy a \$120 testing fee per quarter,²¹ but Bush Gardens failed to include this cost in its pro forma operating expenses. Accordingly, Commission Staff is increasing pro forma operating expenses by \$480²² to reflect the annual cost to test Bush Gardens’ effluent.

(D) Maintenance of Structures and Improvements. Bush Gardens reported maintenance of structures and improvements expense of \$1,240 for the test year. In 2015, Bush Gardens replaced a blower motor and a pump, and it has requested that these costs be included in its test-year maintenance of structures and improvements expense.²³

²⁰ Bush Gardens’ Responses to Staff’s First Request, Item 7.a., Exhibit 3.

²¹ *Id.*, Cover Letter at 2, Exhibit 22.

²² \$120 (Quarterly Testing Fee) x 4 (Quarters) = \$480.

²³ *Id.*, Cover Letter at 2, Exhibit 23.

In reviewing the supporting invoice, Commission Staff discovered that Bush Gardens had installed a new discharge pipe in 2015 and had incorrectly reported it as a test-year expense. Furthermore, the cost of the discharge pipe, the blower motor, and pump are considered capital expenditures that should be depreciated rather than recorded as expenses. Commission Staff is reducing pro forma operating expenses by \$1,240 to eliminate the cost of the discharge pipe. The depreciation of the capital expenditures is contained in a following section.

(E) Depreciation. Bush Gardens reported test-year depreciation expense of \$1,317 is calculated as follows:²⁴

	Cost	Depreciation	
		Lives	Expense
Fence	\$ 1,000	15	\$ 67
Treatment Plant	25,000	20	1,250
Pro Forma Depreciation Expense			<u>\$ 1,317</u>

When questioned by Commission Staff at the field review, Bush Gardens explained that a used treatment plant was obtained by barter, and therefore, the original cost of the plant is unknown. At the field review, Bush Gardens explained that the plant and fence costs represented the estimated replacement cost of the treatment plant.

In responding to a Commission Staff interrogatory, Bush Gardens admitted that it does not have documentation to support the cost of the plant or fence that the "values were given as an estimate of the cost to purchase and construct the plant and fence when it was installed."²⁵ In a separate response, Bush Gardens provided a breakdown

²⁴ Application, ARF Form-1 – Attachment SAO-S – September 2011, Pro Forma Adjustments – Sewer Utility.

²⁵ Bush Gardens' Responses to Staff's First Request, Item 15.a.

of the “Approximate Price” to construct each component of plant and explained that the treatment plant was constructed as part of the development of Bush Gardens.²⁶

Given Bush Gardens’ conflicting responses concerning the cost of the treatment facility and fence, its inability to provide documentation of the original construction costs, and that the cost to construct the treatment plant would have been recovered from the sale of the subdivision lots, Commission Staff is recommending that depreciation for the treatment facility and fence be disallowed. Commission Staff is including the depreciation for the discharge pipe, the blower motor, and the pump in its depreciation adjustment. Test-year depreciation expense is being decreased by \$1,064 as follows:

	Cost	Depreciation	
		Lives	Expense
Discharge Pipe	\$ 1,240	30	\$ 41
Pump and Blower Motor	1,121	10	112
			<hr/>
Pro Forma Depreciation Expense			153
Less: Test-Year Depreciation Expense			<hr/> (1,317)
Commission Staff Depreciation Adjustment			<hr/> <u>\$ (1,164)</u>

(F) Property Tax. Bush Gardens included it its test-year operating expenses property tax expense of \$100. To support its requested property tax expense, Bush Gardens provided the property tax statement for the treatment plant and the 70 acres surrounding the plant showing that the property tax was \$124 in 2015.²⁷ According to Bush Gardens, the treatment plant has been “excepted from this surrounding acreage

²⁶ *Id.*, Item 2.e.

²⁷ *Id.*, Item 16.a. and Exhibit 16.

when the plant property was transferred to BGE,” but a tax evaluation for the treatment plant exclusively was not available at the time of the response.²⁸

An adjustment to reflect Bush Gardens’ property tax estimate would not meet the ratemaking criteria of being known and measurable. Accordingly, Commission Staff reduced pro forma operating expense by \$100 to remove the property tax estimate.

Determination of Allowable Net Operating Income (“NOI”)

Using the operating-ratio method, Staff calculated an allowable revenue requirement for Bush Gardens of \$12,300, as shown below:

Operating Expenses	\$	10,757
Divided by: Operating Ratio		<u>88%</u>
Total Revenue Requirement	\$	<u><u>12,224</u></u>

Rate Calculated by Commission Staff

Bush Gardens has proposed a monthly flat rate for the customers served by its operations. A monthly flat-rate charge for waste water service has been found to be acceptable by the Commission in the past. To calculate the monthly charge for the customers of Bush Gardens, Commission Staff took the Total Revenue Requirement determined by Commission Staff divided by eight, the number of customers currently being served, and then divided by 12 months. This produces a rate of \$127.33 per month per customer, as shown in the Attachment to this Staff Report.

Nonrecurring Charges proposed by Busch Gardens

Bush Gardens proposed certain nonrecurring charges in its application, a Connection Inspection Fee of \$75 and a Late Payment Charge of 10 percent of the current past due amount. However, the public notice filed in Bush Garden’s application

²⁸ *Id.*, Item 16.a.

failed to include these charges. The Commission should direct Bush Gardens to notify its customers concerning these charges and provide the subsequent documentation validating that the notice has been given to the customers.

1. The Connection Inspection Fee. Bush Gardens' response to Staff's First Request asked that the proposed Connection Inspection Fee be reduced to the current fee charged by the Kentucky State Plumbing Inspector, \$45 per call. An inspection by the Kentucky State Plumbing Inspector is required to be performed before any new or additional connections are made to the current system. Bush Gardens further clarified the policy concerning the Connection Inspection Fee, stating that the current customers would not be required to be inspected or charged this fee.²⁹ Bush Gardens should amend the policy concerning this fee if approved by the Commission at the time they are instructed to file tariff pages by the Commission.

2. Late Payment Charge. Bush Gardens proposes to charge a 10 percent late payment charge for the current past due amount to customers who pay their monthly bills late. This charge is standard for utility companies and the majority of regulated sewer utilities charge a 10 percent late payment fee. Bush Gardens' request should be accepted by the Commission.

Tariff Submission

Bush Gardens filed with its application an initial tariff. The tariff is based upon a tariff template obtained from Commission Staff.³⁰ In response to Staff's First Request, Bush Gardens has requested several changes in this tariff to be considered by the

²⁹ Bush Gardens' Responses to Staff's First Request, Item 19.a.

³⁰ *Id.*

Commission. Bush Gardens should, subsequent to the issuance of the Final Order in this proceeding, work closely with the Commission's Tariff Branch Staff to craft language that clearly states the utility's policies and complies with the applicable statutes and regulations.

Item D: The Connection Inspection Fee. As previously stated, the policy attached to this charge should be revised to clarify that this charge will be assessed only for new connections requested by customers of the utility.

Item G: Sewer Lines. In response to Commission Staff information requests, Bush Gardens stated that the inspections identified in Item G are limited to future inspections. Bush Gardens should revise the language in the tariff and clarify that the policy concerning Sewer Lines is applicable only to new customers requesting to connect to the utility's system.³¹ Further, the revision should clarify that the charge refers to the Connection Inspection Fee as revised by Bush Gardens.

Signatures



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



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

³¹ Bush Gardens' Responses Staff's First Request, Item 20.

ATTACHMENT
STAFF REPORT CASE NO. 2015-00306
RATES CALCULATED BY STAFF

Monthly Sewer Rates

Flat Rate	\$127.33
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Nonrecurring Charges

Connection Inspection Fee	\$45.00
Late Payment Charge	10%

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