

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF P. R. WASTEWATER)
MANAGEMENT, INC. FOR AN ALTERNATIVE) CASE NO.
RATE ADJUSTMENT) 2018-00339

NOTICE OF FILING OF COMMISSION STAFF REPORT

Notice is hereby given that, in accordance with the Commission's Order of November 27, 2018, 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 November 27, 2018 Order, P. R. Wastewater Management is required to file written comments regarding the findings of Commission Staff no later than 14 days from the date of this report.



Gwen R. Pinson
Executive Director
Public Service Commission
P.O. Box 615
Frankfort, KY 40602

DATED MAR 22 2019

cc: Parties of Record

STAFF REPORT
ON
P. R. WASTEWATER MANAGEMENT
CASE NO. 2018-00339

P. R. Wastewater Management provides wastewater service to approximately 352¹ customers residing in the Persimmon Ridge Subdivision in Shelby County, Kentucky.² On October 5, 2018, P. R. Wastewater Management filed an application (Application) for an adjustment of its rates. By letter dated October 16, 2018, the Commission notified P. R. Wastewater Management that the Application was rejected as deficient. After P. R. Wastewater Management corrected its filing deficiencies, the utility was notified by letter on November 15, 2018, that its Application was deemed filed on November 5, 2018. In its application, P. R. Wastewater Management proposes an adjustment to its flat monthly wastewater service rate pursuant to 807 KAR 5:076. The proposed rate would increase a monthly bill from \$26.30 to \$35.00, an increase of \$8.70, or 33.08 percent. To ensure the orderly review of the Application, the Commission established a procedural schedule by Order dated November 27, 2018. Subsequent to that date, Commission Staff (Staff) held numerous conversations with the owner of P. R. Wastewater Management about possibly suspending or withdrawing the rate application in anticipation of a potential buyer of the utility. Subsequently, the owner of P. R. Wastewater Management decided to proceed with the rate application. As a result of the

¹ Application at 3.

² *Annual Report of P. R. Wastewater Management, Inc. to the Public Service Commission for the Calendar Year Ended December 31, 2017 (Annual Report)* at 9.

delay, the Commission issued an amended procedural schedule on February 5, 2019, to allow more time to process the case.

To comply with the requirements of 807 KAR 5:076, Section 9, P. R. Wastewater Management based its requested rates on a historical test period ending December 31, 2017. That test period coincides with the reporting period shown in its most recent Annual Report on file with the Commission at the time it filed the Application.

Using its pro forma test-year operations, P. R. Wastewater Management determined that it could justify a revenue increase of \$41,647, or 37.49 percent.³ The rates requested by P. R. Wastewater Management would increase the monthly bill of a typical residential customer by \$8.70, from \$26.30 to \$35.00, or approximately 33.08 percent. P. R. Wastewater Management calculated its requested revenue requirement using the operating ratio method. Pursuant to this method, the allowable revenue requirement is calculated by dividing pro forma operating expenses (\$134,409) by 88 percent less the normalized revenue amount (\$111,901), which equals the revenue increase needed (\$41,647)⁴

Operating Expenses	\$ 134,409
Divide by: Operating Ratio	<u>88%</u>
Operating Revenues	\$ 152,737.50
Less: Adjusted Revenue	<u>\$ 111,091</u>
Revenue Increase needed	<u>\$ 41,647</u>

³ Application, "PRWW 2018 Statement of Adjusted Operations/Revenue Requirement/Billing Analysis."

⁴ *Id.*

The percentage increase of 37.49 multiplied by the current monthly rate of \$26.30 would equal a monthly rate increase of \$9.86 or a \$36.16 fee per customer monthly.⁵ However, P. R. Wastewater Management is requesting a rate increase of \$8.70 or a \$35.00 monthly fee per customer.

To determine the reasonableness of the rates requested by P. R. Wastewater Management, Staff performed a limited financial review of P. R. Wastewater Management's test-year operations. The scope of Staff's 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 material. Insignificant and immaterial discrepancies were not necessarily pursued or addressed.

Staff's findings are summarized in this report. David Foster and Mike Foley reviewed the calculation of P. R. Wastewater Management Overall Revenue Requirement. Jason Green and Elizabeth Stefanski reviewed P. R. Wastewater Management's reported revenues and rate design.

SUMMARY OF FINDINGS

1. Overall Revenue Requirement and Required Revenue Increase. By applying the Operating Ratio Method, as generally accepted by the Commission, Staff found that P. R. Wastewater Management's Overall Revenue Requirement is \$148,844 and that an \$37,753 revenue increase, or 33.98 percent, to pro forma present rate revenues is necessary to generate the Overall Revenue Requirement.

⁵ *Id.*

2. Wastewater Service Rates. Based on its review, Staff determined that P. R. Wastewater Management's adjusted test-year operations support a monthly flat rate of \$35.24, an increase of \$8.94, or 33.99 percent, from its current rate of \$26.30. Staff's calculations are shown and discussed in the remaining sections of this report.

PRO FORMA OPERATING STATEMENT

P. R. Wastewater Management's Pro Forma Operating Statement for the test year ended December 31, 2017, as determined by Staff, appears below.

	Test Year	Adjustment	(Ref.)	Pro Forma
Operating Revenues				
Residential Revenues	<u>109,480</u>	<u>1,611</u>	(A)	<u>111,091</u>
Total Sewage Service Revenues	<u>109,480</u>	<u>1,611</u>		<u>111,091</u>
Operating Expenses				
Operation and Maintenance Expenses				
Owner/Manager Fee	-	3,600	(B)	3,600
Pumping System	7,455	1,804	(C)	9,259
Fuel and Power for Pumping & Treatment	29,390	-		29,390
Chemicals	5,301	1,695	(D)	6,996
Misc. Supplies/Exp	6,463	-		6,463
Maint. Pumping System	2,229	-		2,229
Cust. Records/Collecting	11,146	-		11,146
Admin. & Gen. Salaries	28,592	908	(E)	29,500
Office Supplies/Exp.	2,795	-		2,795
Outside Services	10,085	3,012	(F)	13,097
Rent	-	1,800	(G)	1,800
Miscellaneous Exp.	652	-		652
Total Operation and Maintenance Expenses	<u>104,108</u>	<u>12,819</u>		<u>116,927</u>
Depreciation Expense	5,155	(192)	(H)	4,963
Amortization Expense	-	4,366	(I)	4,366
Taxes Other Than Income	<u>8,358</u>	<u>(3,631)</u>	(J)	<u>4,727</u>
Total Operating & Maintenance Expenses	<u>117,621</u>	<u>13,362</u>		<u>130,983</u>
Net Operating Income	<u>\$ (8,141)</u>	<u>\$ (11,751)</u>		<u>\$ (19,892)</u>

(A) Billing Analysis Adjustment. To calculate the normalized revenue for the test-year, P. R. Wastewater Management multiplied its monthly fee of \$26.30 by the number of its customers (352) and multiplied the resulting subtotal by the number of months in a year (12). The normalized revenue amount of \$111,091 was \$1,611 higher than the recorded test-year revenue of \$109,480, resulting in an adjustment to the test-year revenue amount, which increases it by \$1,611. Commission Staff agrees with the adjustment.

(B) Owner/Manager Fee. P. R. Wastewater Management is owned and operated by Lawren Just. During the test year, P. R. Wastewater Management reported an owner/manager fee to be paid to the utility's owner for serving as its chief executive officer. The Commission has historically allowed small, investor-owned sewer utilities, such as P. R. Wastewater Management, recovery of a \$3,600-owner/manager fee to be paid to the utility's owner for serving as its chief executive officer. In the cases of very small utilities, the fee is also considered compensation for providing additional services.⁶ In the Application, P. R. Wastewater Management noted that it had reported Owner/Manager fee expenses using incorrect accounts. P. R. Wastewater Management proposed to reclassify the Owner/Manager fee from the Administrative and General

⁶ In Case No. 2007-00397, *Application of Woodland Estates Sewage System for an Adjustment of Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC. Dec. 27, 2007), the Commission found that the \$3,600 owner manager fee awarded to Woodland Estates Sewage System, which served 24 customers at the time its rate application was filed, was appropriate compensation for the owner serving as the utility's executive officer and for the owner's contribution to the utility of office space, office supplies, telephone service, billing and collection services, and bookkeeping services. In Case No. 2005-00036, *Application of Lewis Sanitation Company, Inc., D/B/A Garden Heights Sewer Division for an Adjustment of Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC Apr. 14, 2005), the Commission found that the \$3,600 owner manager fee was appropriate compensation for only the owner's executive oversight of the utilities' operations. In addition to the owner manger fee, the Commission allowed rate recovery for expenses that were incurred by the utility for bookkeeping services, office rent, office supplies, office utilities, and reimbursement to the owner for transportation expenses. Lewis Sanitation Company, Inc. served 108 customers at the time its rate application was filed.

Salaries account to the Owner/Manager fee account. Staff notes that although the reclassification adjustment proposed by P. R. Wastewater Management does not have an effect on the calculation of P. R. Wastewater Management's Overall Revenue Requirement or Required Revenue Increase, it accepted the adjustment to comply with the accounting requirements of the Uniform System of Accounts (USoA)

(C) Pumping System. During the test year, P. R. Wastewater Management added a data monitoring service for four lift stations at an expense of \$300 a month, or \$3,600 annually. P. R. Wastewater Management reported an expense of \$1,796 for the installation and partial years' expense of system monitoring. P. R. Wastewater Management proposed an adjustment of \$1,804 to annualize the expense they will incur for this service on a going forward basis.⁷ Staff agrees with the adjustment and has increased test-year expenses by \$1,804.

(D) Chemicals. During the test year, P. R. Wastewater Management reported \$5,301 for chemical expenses. Subsequent to the test year, P. R. Wastewater Management switched from chlorine tablets to liquid chlorine to treat its effluent to comply with the Division of Water testing standards. P. R. Wastewater Management requested to increase test-year chemical expenses by \$1,695 to account for its increased chemical costs. Staff agrees with P. R. Wastewater Management's proposed adjustment and has increased test-year expenses by \$1,695.

(E) Admin & Gen. Salaries. P. R. Wastewater Management reported test-year Administrative and General Salaries of \$28,592, which included the Owner/Manager fee

⁷ Application, "PRWW 2018 Statement of Adjusted Operations/Revenue Requirement/Billing Analysis, Reference Notes, Item C."

discussed in Item (B) above. P. R. Wastewater Management proposed an overall adjustment of \$3,841 to account for reclassifying the Owner/Manager fee to its proper USoA account and its operator being made a full-time salary employee. P. R. Wastewater Management did not provide their calculation. After speaking with P. R. Wastewater Management's owner, Staff determined that the current level of salaries and wages for one full-time and one part-time employee is \$29,500 annually. Staff calculated an adjustment to increase Admin & Gen Salaries by \$908 as shown below.

Full Time Employee	\$ 24,000
Part Time Employee	<u>5,500</u>
Total Pro Forma Wages	\$ 29,500
Less: Test Year Wages	<u>(28,592)</u>
Pro Forma Adjustment	<u>\$ 908</u>

(F) Outside Services. P. R. Wastewater Management reported \$10,085 for test-year Outside Services Expense. This amount included expenses for accounting, lab testing fees, and banking services. P. R. Wastewater Management proposed in its Application to increase test-year expense by \$3,012 to account for a \$155 increase in accounting fees, \$1,717 increase in lab testing costs, and \$1,140 a year over the next five years for smoke testing of their collection system. Staff agrees with this adjustment and has increased test-year expenses by \$3,012.

(G) Rent. P. R. Wastewater Management proposes to include \$1,800 in its test-period operating expenses to reflect its share of office rent. P. R. Wastewater Management currently shares an office with another business owned by Lawren Just, the owner of P.R. Wastewater Management. However, during the test year, Lawren Just did not allocate any of the costs of the shared office expense to P. R. Wastewater

Management. The \$150 per month represents P. R. Wastewater Management's allocation of the costs associated with the office, which includes: a landline telephone; an internet connection; a computer; a fax machine; a printer; a copy machine; and filing cabinets. In reviewing the benefits received by P. R. Wastewater Management in sharing the office with affiliated companies, Commission Staff believes that the fee is reasonable and that the Commission should accept P. R. Wastewater Management's proposed adjustment.

(H) Depreciation. P. R. Wastewater Management made an adjustment in its Application reducing their reported test-year depreciation expense of \$5,155 by \$192. This adjustment was the result of P. R. Wastewater Management's proposal to remove assets that were fully depreciated at the end of 2017 and to include depreciation for a new pump that was added to their system. Staff agrees with P. R. Wastewater Management's decrease to depreciation expense of \$192.

(I) Amortization Expense. P. R. Wastewater Management included amortization expense in its Application in the amount of \$4,366. The total of this adjustment consisted of three parts.

Kentucky Pollutant Discharge Elimination System (KPDES) Permit: During the test year, P. R. Wastewater Management paid a fee of \$3,700 to renew its KPDES permit. The renewed permit expires five years from its origination date. P. R. Wastewater Management recorded the renewal fee in Taxes Other Than Income. The KPDES permit renewal fee is a regulatory asset that should be amortized over the five-year life of the permit. P. R. Wastewater Management proposed to remove the fee from Taxes Other Than Income and amortize the fee over five years. Staff agrees with their adjustment.

Rate Case Assistance Fee: P. R. Wastewater Management also requested recovery of \$1,200 to account for the three-year amortization of the \$3,600 rate case expense it incurred to prepare, file and adjudicate the application filed in this proceeding. Staff agrees that the recovery of amortization of this rate case expense is appropriate.

Repairs of Treatment and Disposal Plant: Subsequent to the test year, P. R. Wastewater Management made repairs to multiple grinder pumps, a lift station pump, and multiple aerators. The total expense incurred by P. R. Wastewater Management for these repairs was \$12,128. P. R. Wastewater Management requested to amortize this expense over five years. Staff agrees with the adjustment and has included it in its amortization expense. As shown below, Staff calculated the total amortization expense to be \$4,366.

	<u>Cost</u>	<u>Amortization Period</u>	<u>Annual Amortization Expense</u>
Permit Fees	\$ 3,700	5	\$ 740
Rate Case Expense	3,600	3	1,200
Repairs to Plant	12,128	5	<u>2,426</u>
Amortization Expense			<u><u>\$ 4,366</u></u>

(J) Taxes Other Than Income. As discussed in Item (E), Staff determined that P. R. Wastewater Management’s test-year employee wages will increase by \$908 due to changes in P. R. Wastewater Management’s staffing. After removing expenses for their KPDES permit, as discussed in Item (I), P.R. Wastewater Management’s test-year FICA taxes will increase by \$69. Accordingly, Staff decreased test-year Taxes Other Than Income by \$3,631.

Increase to Employee Wage Expense	\$ 908
Times: 7.65% FICA Tax Rate	<u>7.65%</u>
FICA Tax Rate Increase	\$ 69
Less: KPDES Fee	<u>(3,700)</u>
Total Adjustment	<u><u>\$ (3,631)</u></u>

DETERMINATION OF ALLOWABLE OPERATING INCOME (NOI)

Staff calculated P. R. Wastewater Management’s allowable NOI using the operating ratio method as historically accepted by the Commission.⁸ Pursuant to this method, the allowable NOI is calculated by dividing pro forma operating expenses, less the Income Tax Expense, by 88 percent and subtracting operating expenses from the result. Using this method, Staff calculated P. R. Wastewater Management’s allowable NOI to be \$17,861 as shown below.

Operating Expenses	\$ 130,983
Divide by: Operating Ratio	<u>88%</u>
Operating Revenues	148,844
Less: Operating Expenses	<u>(130,983)</u>
Allowable NOI	<u><u>\$ 17,861</u></u>

⁸ 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 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. (See 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. (See Case No. 7982, *Notice of Application of Fern Lake Company* (Ky. PSC Aug. 27, 1981) at 3).

CALCULATION OF OVERALL REVENUE REQUIREMENT
AND REQUIRED REVENUE INCREASE

To recover all pro forma operating expenses and to generate the allowable NOI, P. R. Wastewater Management requires an overall revenue of \$148,844. As shown below, a \$37,753 revenue increase, or 33.98 percent, is necessary to produce the Overall Revenue Requirement.

Operating Expenses	\$ 130,983
Allowable NOI	<u>17,861</u>
Revenue Requirement	\$ 148,844
Less: Pro Forma Present Rate Revenues	<u>(111,091)</u>
Required Revenue Increase	<u>\$ 37,753</u>
Percentage	<u>33.98%</u>

RATE CALCULATED BY STAFF

P. R. Wastewater Management's current rate design is a monthly rate of \$26.30 per Residential customer and \$26.30 per Nonresidential customer. P. R. Wastewater Management proposes to continue the current rate design and to recover the requested revenue requirement by increasing the amount of the flat monthly rate. Staff agrees with P. R. Wastewater Management's decision to continue using the current rate design. Using Staff's revenue requirement of \$148,844, Staff determines the flat monthly rate to be \$35.24 per Residential customer and \$35.24 per Nonresidential customer.⁹

⁹ \$148,844 (Revenue Requirement) divided by 12 (Months) divided by 352 (Customers) = \$35.24.

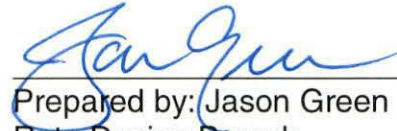
Signatures:



Prepared by: David P. Foster
Revenue Requirements Branch
Division of Financial Analysis



Prepared by: Mike Foley
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Prepared by: Jason Green
Rate Design Branch
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Prepared by: Elizabeth Stefanski
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ATTACHMENT

ATTACHMENT TO A STAFF REPORT OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2018-00339 DATED **MAR 22 2019**

Monthly Water Rates

Residential Flat Rate	\$35.24
Nonresidential Flat Rate 0-12,000 Gallons	\$35.24

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