

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF EVERGREEN SEWAGE )	
DISPOSAL SYSTEM FOR A RATE )	
ADJUSTMENT PURSUANT TO THE )	CASE NO. 92-248
ALTERNATIVE RATE FILING PROCEDURE )	
FOR SMALL UTILITIES )	

O R D E R

On July 1, 1992, Evergreen Sewage Disposal System ("Evergreen") filed its application for Commission approval of a proposed increase in its rates for sewer service. Commission Staff, having performed a limited financial review of Evergreen's operations, has prepared the attached Staff Report containing Staff's findings and recommendations regarding Evergreen's proposed rates. All parties should review the report carefully and provide any written comments or requests for a hearing or informal conference no later than 15 days from the date of this Order.

IT IS THEREFORE ORDERED that all parties shall have 15 days from the date of this Order to provide written comments regarding the attached Staff Report or requests for a hearing or informal conference. If no request for a hearing or informal conference is received, then this case will be submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this 11th day of December, 1992.

PUBLIC SERVICE COMMISSION

ATTEST:

  
Executive Director

  
For the Commission

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STAFF REPORT

Prepared By: Mark C. Frost  
Public Utility Financial  
Analyst, Chief  
Water and Sewer Revenue  
Requirements Branch  
Rates and Tariffs Division

Prepared By: Nicky Moore  
Public Utility Rate Analyst  
Communications, Water and  
Sewer Rate Design Branch  
Research Division

STAFF REPORT

ON

EVERGREEN SEWAGE DISPOSAL SYSTEM

CASE NO. 92-248

A. Preface

On June 12, 1992, Evergreen Sewage Disposal System ("Evergreen") submitted its application seeking to increase its rates pursuant to the Alternative Rate Filing Procedure for Small Utilities. However, the application was not considered filed until July 1, 1992. Evergreen's proposed rates would produce an increase in its annual revenues of \$1,339, an increase of 18.34 percent over test-period normalized revenues from rates of \$7,301.

In order to evaluate the requested increase, the Commission Staff ("Staff") chose to perform a limited financial review of Evergreen's operations for the test-period, the calendar year ending December 31, 1991. On August 19, 1992, Mark C. Frost of the Commission's Division of Rates and Tariffs obtained Evergreen's general journal and Evergreen agreed to provide copies of its test-period invoices, canceled checks, permits, and routine maintenance service contract. After numerous Staff telephone calls, Evergreen provided this information on September 14, 1992, and the limited review of Evergreen's test-period operations was performed at the Commission's offices in Frankfort, Kentucky.

Mr. Frost is responsible for the preparation of this Staff Report except for Section B, Operating Revenues; Section D, Rate Design; and Appendix A, which were prepared by Nicky Moore of the Commission's Research Division. Based on the findings contained in

this report, Staff recommends that Evergreen be allowed to increase its annual revenues from rates by \$2,419.

### Scope

The scope of the review was limited to obtaining information as to whether the test-period operating revenue and expenses were representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

### B. Analysis of Operating Revenues and Expenses

#### Operating Revenues

In its application, Evergreen reported test year revenue of \$7,301. The annual report for the same period of time shows revenue collected in the amount of \$7,706. The income reported in the annual report was based on revenue that would be collected from 38 customers. After investigation, it was determined that because of local road construction, Evergreen had lost two customers and now has 36 customers. The two customers that were eliminated would have produced \$405 in revenues. Therefore, for the purpose of this report, the Staff will use \$7,301 as the adjusted test year revenue.

#### Operating Expenses

Evergreen reported actual and pro forma test-period operating expenses of \$10,294 and \$11,434, respectively. The following are Staff's recommended adjustments to Evergreen's actual test-period operations:

Owner/Manager Fee: Evergreen reported an owner/manager fee expense of \$2,400 for the test period. Based on its discussion with Clarice Howard, the person who prepared Evergreen's application, Staff determined that test-period owner manager fee represented a misclassification of Evergreen's routine maintenance fee.

Upon review of Evergreen's routine maintenance contract, Staff is of the opinion that the fee is reasonable and should be included in test-period operations. Further, the Commission's practice has been to allow sewer utilities of Evergreen's size an owner/manager fee of \$2,400, which Staff recommends be allowed in this instance. Therefore, test-period operating expenses have been increased by \$2,400 to reflect the inclusion of an owner/manager fee and routine maintenance fee in Evergreen's operations.

Purchased Water: Evergreen reported a test-period level of water expense of \$316. A detailed analysis of the test-period invoices and canceled checks revealed that the actual water expense was \$346, a difference of \$30 from the amount Evergreen reported. Accordingly, water expense has been increased by \$30.

Effluent Testing: Evergreen reported an effluent testing expense of \$414 for the test-period. A detailed analysis of the test-period invoices and canceled checks revealed that the actual

effluent testing expense was \$360,<sup>1</sup> a difference of \$54 from the amount Evergreen reported. Accordingly, effluent testing expense has been decreased by \$54.

Sludge Hauling: Evergreen proposed a pro forma level of sludge hauling expense of \$720, an increase of \$140 above its test-period level. In November 1991, Perry's Septic Tank Service increased its sludge hauling fee from \$80 to \$90 per load. Evergreen's proposed adjustment reflects this increased fee.

An adjustment based on the increased fee would meet the rate-making criteria of known and measurable. Upon review of the Perry's Septic Tank Service invoices, Staff determined that 4 loads of sludge were hauled in the test period. Based on the increased fee and the number of loads hauled during the test period, Staff determined that Evergreen's pro forma sludge hauling expense would be \$360, a difference of \$220 from the actual amount Evergreen reported. Accordingly, sludge hauling expense has been decreased by \$220.

Maintenance of Pumping System: Evergreen reported test-period maintenance of pumping system expense of \$1,320. Upon review of the test-period invoices, Staff noted that Evergreen had reported \$624 of maintenance that was performed in the previous year. Therefore, Staff recommends that maintenance of pumping expense be

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<sup>1</sup> Quarterly Reporting Fee	\$ 10
Times: 4-Quarters	x 4
Annual Reporting Fee	\$ 40
Effluent Testing	+ 320
Test-Period Effluent Reporting & Testing	<u>\$ 360</u>

decreased by \$624 to eliminate items that occurred outside the test period.

Administrative and General Salaries: Evergreen reported administrative and general salaries expense of \$700 for the test period. Based on its review of the canceled checks, Staff determined that this amount represented payments to Evergreen's bookkeeper.

The bookkeeping service was performed by Ms. Howard in the test period; however, Evergreen's owner has taken over this duty. Since Evergreen is no longer using a bookkeeper, the cost of this service should be eliminated from test-period operations. Accordingly, operating expenses have been decreased by \$700 to reflect the discontinued bookkeeping service.

Miscellaneous: Evergreen reported test-period miscellaneous expense of \$893. Upon review of the test-period invoices and canceled checks, Staff determined that miscellaneous expense was \$677, a difference of \$216 from the amount Evergreen reported. Accordingly, miscellaneous expense has been decreased by \$216.

Depreciation: Evergreen's test-period depreciation expense was \$2,377. In Case No. 9514, the Commission determined that Evergreen "was not entitled to depreciation expense for rate-making

purposes on utility plant-in-service acquired on or before August 31, 1980, as the assets were fully contributed."<sup>2</sup>

On July 1, 1992, Evergreen filed a copy of its depreciation schedule which revealed that test-period depreciation expense is for plant that was placed in service in 1978 and therefore, was fully funded by contributions in aid of construction. To be consistent with the Commission's decision in Case No. 9514, Staff recommends that operating expenses be decreased by \$2,377 to reflect the elimination of depreciation expense.

Taxes Other Than Income Tax: Evergreen reported test-period taxes other than income tax expense of \$444. Upon its review of the invoices and canceled checks, Staff determined that Evergreen had included the 1990 property tax and ad valorem assessment in its test-period operations. To eliminate the 1990 taxes, Staff recommends that taxes other than income tax expense be reduced by \$217.

Notes Payable: Evergreen proposed a pro forma notes payable expense of \$1,000. Evergreen borrowed \$1,000 to pay for a required state water permit. A copy of the note payable to Farmers Bank & Capital Trust was attached to Evergreen's application.

The payment of principal is not an expense or income statement item as proposed by Evergreen, but rather a balance sheet

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<sup>2</sup> Case No. 9514, The Application of Evergreen Sewage Disposal System, Inc., for an Adjustment of Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities, Order issued June 17, 1986, Page 3.



transaction. Therefore, Staff recommends that Evergreen's proposed adjustment to include its principal payment as an operating expense be denied.

If the associated debt was not used to pay current operating expenses, the Commission's practice has been to allow a dollar-for-dollar coverage of interest expense in the calculation of revenue requirement. In this instance if Evergreen's water permit covered a period greater than one year, Staff would recommend that Evergreen be allowed to amortize the permit cost over its useful life and to recover its interest expense. To determine whether Evergreen's permit covered a period greater than 1 year, Staff instructed Evergreen to file a copy of its water permit.

Evergreen failed to provide the requested documentation and therefore, Staff recommends that Evergreen's test-period operations not be adjusted to reflect either the amortization or the interest expense associated with Evergreen's state water permit.

#### Operations Summary

Based on the recommendations of Staff contained in this report, Evergreen's operating statement would appear as set forth in Appendix B to this report.

#### C. Revenue Requirements Determination

The approach frequently used by this Commission to determine revenue requirements for small, privately-owned utilities is the operating ratio. This approach is used primarily when there is no basis for rate-of-return determination or the cost of the utility

has fully or largely been recovered through the receipt of contributions. Staff recommends the use of this approach in determining Evergreen's revenue requirement.

Staff's adjusted operations provide Evergreen with an operating ratio of 113.9 percent<sup>3</sup>. Combined with Evergreen's proposed increase of \$1,339, the result is an operating ratio of 96.25 percent.<sup>4</sup>

Staff is of the opinion that an 88 percent operating ratio would allow Evergreen sufficient revenues to cover its operating expenses and to provide for equity growth. In this proceeding, an operating ratio of 88 percent and an allowance for the appropriate state and federal income taxes results in a revenue requirement of \$9,720.<sup>5</sup> Therefore, Staff recommends that Evergreen be allowed to increase its annual operating revenue by \$2,419.<sup>6</sup>

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<sup>3</sup> \$8,316 + \$7,301 = 113.9%.

<sup>4</sup> \$8,316 + (\$7,301 + \$1,339) = 96.25%.

<sup>5</sup> Adjusted Operating Expenses	\$ 8,316
Recommended Operating Ratio	+ 88%
Subtotal	<u>\$ 9,450</u>
Less: Adjusted Operating Expenses	- 8,316
Net Operating Income	<u>\$ 1,134</u>
Income Tax Gross-Up Factor	x1.23839009
Net Operating Income Before Income Tax	<u>\$ 1,404</u>
Add: Adjusted Operating Expenses	\$ 8,316
Revenue Requirement	<u>\$ 9,720</u>


<sup>6</sup> Revenue Requirement	\$ 9,720
Less: Normalized Operating Revenue	- 7,301
Recommended Revenue Increase	<u>\$ 2,419</u>

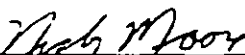
D. Rate Design

As part of its application, Evergreen filed a schedule of its existing and proposed rates. Evergreen did not propose to change its current rate structure, therefore, an increase granted in this case should be added to the existing rate structure.

Staff recommends that the rates as set out in Appendix A, be approved for services rendered.

E. Signatures

  
Prepared By: Mark C. Frost  
Public Utility Financial  
Analyst, Chief  
Water and Sewer Revenue  
Requirements Branch  
Rates and Tariffs Division

  
Prepared By: Nicky Moore  
Public Utility Rate Analyst  
Communications, Water and  
Sewer Rate Design Branch  
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APPENDIX A  
TO STAFF REPORT CASE NO. 92-248

The Staff recommends the following rate be prescribed for customers of Evergreen Sewage Disposal System..

<u>Customers Class</u>	<u>Rates</u>
Residential	\$22.55 per month

APPENDIX B  
TO STAFF REPORT CASE NO. 92-248

	Actual Test-Period Operations -----	Pro Forma Adjustments -----	Adjusted Operations -----
Operating Revenues:			
Flat Rate - Residential	\$ 7,706	\$ (405)	\$ 7,301
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Operating Expenses:			
Operation Exp:			
Owner/Manager-Mgt. Fee	\$ 2,400	\$ 0	\$ 2,400
Effluent Testing Expense	414	(54)	360
Sludge Hauling	580	(220)	360
Water Expense	316	30	346
Electric Expense	850	0	850
Maintenance Exp:			
Routine Maint. Service Fee	0	2,400	2,400
Maintenance - Pumping System	1,320	(624)	696
Administrative & General Exp:			
Admin. & General Salaries	700	(700)	0
Miscellaneous General	893	(216)	677
Depreciation Expense	2,377	(2,377)	0
Notes Payable - Principal	0	0	0
Taxes Other Than Income Tax	444	(217)	227
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Total Operating Expenses	\$ 10,294	\$ (1,978)	\$ 8,316
	-----	-----	-----
Net Operating Income	\$ (2,588)	\$ 1,573	\$ (1,015)
Other Deductions:			
Interest Expense	0	0	0
	-----	-----	-----
Net Income	\$ (2,588)	\$ 1,573	\$ (1,015)
	=====	=====	=====