

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF CONSOLIDATED MANAGEMENT)
SERVICES, INC. OF DAVIESS COUNTY, KENTUCKY,)
FOR (1) A CERTIFICATE OF PUBLIC CONVENIENCE)
AND NECESSITY, AUTHORIZING AND PERMITTING)
SAID COMPANY TO CONSTRUCT SEWAGE TREATMENT) CASE NO.
FACILITIES CONSISTING OF PLANT ADDITION, AND) 92-083
IMPROVEMENTS TO THE EXISTING SEWER SYSTEM;)
(2) APPROVAL OF THE PROPOSED PLAN OF FINANCING)
OF SAID PROJECT; AND (3) APPROVAL OF THE)
INCREASED SEWER RATES PROPOSED TO BE CHARGED)
BY THE COMPANY TO CUSTOMERS OF THE COMPANY)

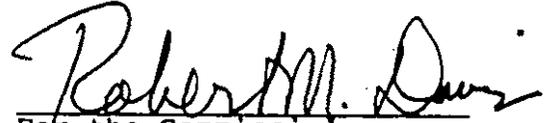
O R D E R

On October 5, 1992, Consolidated Management Services, Inc. ("Consolidated") 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 Consolidated's operations, has prepared the attached Staff Report containing Staff's findings and recommendations regarding Consolidated'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 4th day of January, 1993.

PUBLIC SERVICE COMMISSION


For the Commission

ATTEST:



Executive Director

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF CONSOLIDATED)
MANAGEMENT SERVICES, INC. OF DAVIESS)
COUNTY, KENTUCKY, FOR (1) A CERTIFICATE)
OF PUBLIC CONVENIENCE AND NECESSITY,)
AUTHORIZING AND PERMITTING SAID COMPANY)
TO CONSTRUCT SEWAGE TREATMENT FACILITIES)
CONSISTING OF PLANT ADDITION, AND)
IMPROVEMENTS TO THE EXISTING SEWER)
SYSTEM; (2) APPROVAL OF THE PROPOSED)
PLAN OF FINANCING OF SAID PROJECT; AND)
(3) APPROVAL OF THE INCREASED SEWER)
RATES PROPOSED TO BE CHARGED BY THE)
COMPANY TO CUSTOMERS OF THE COMPANY)

CASE NO. 92-083

STAFF REPORT

Prepared By: Carl Combs
Public Utility Financial
Analyst
Water and Sewer Revenue
Requirements Branch
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STAFF REPORT

ON

CONSOLIDATED MANAGEMENT SERVICES, INC.

CASE NO. 92-083

A. Preface

On March 30, 1992, Consolidated Management Services, Inc. ("Consolidated") submitted an application to the Commission seeking a Certificate of Public Convenience and Necessity to construct an addition to its sewage treatment plant facilities, approval of its plan of financing for the construction project and approval to increase its rates.

On October 5, 1992, Consolidated filed a revised application in which it stated that the cost associated with the construction project had been deleted. Since Consolidated no longer seeks Commission approval of the construction project, consideration of the financing plan associated with that project is no longer required.

According to Consolidated, the rates proposed in its revised application would increase its annual revenues by \$19,846.

In order to evaluate the requested increase, the Commission Staff ("Staff") chose to perform a limited financial review of Consolidated's operations for the test period, calendar year 1991. Carl Salyer Combs of the Commission's Division of Rates and Tariffs conducted the review at the offices of Green River Rural Electric Cooperative Corporation ("RECC") in Owensboro, Kentucky on May 12,

1992 and is responsible for this Staff Report except for the sections on operating revenues and rate design which were prepared by Nicky Moore of the Commission's Research Division. During the course of the review, Consolidated was advised that all proposed adjustments to test-year expenses must be supported by some form of documentation, such as an invoice, or that all such adjustments must be known and measurable. Based upon the findings of this report, Staff recommends that Consolidated be authorized no increase in its annual operating revenues.

Scope

The scope of the review was limited to obtaining information to determine whether reported test-period operating revenues 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 their statement of operation, Consolidated shows operating revenues of \$115,084 for the test year. This figure includes \$7,800 collected as tap on fees which is not considered as part of the operating revenue, therefore, the actual operating revenue is \$107,284. At the end of 1991, Consolidated served 393 residential flat rate customers and 395 residential metered rate customers.

Operating Maintenance Expenses

Consolidated reported test-period operating expenses of \$148,304 which it proposed to reduce by \$22,307. Staff's adjustments to test-period operations are discussed in the following sections:

Management Fee

Consolidated reported no test-year payments for management services. The Commission's past practice has been to allow a management fee for sewer utilities. In this instance, Staff is of the opinion that Consolidated is entitled to an annual management fee and that \$2,400 is a reasonable level. Therefore, Staff recommends inclusion of an annual management fee of \$2,400 for rate-making purposes.

Pumping System - Labor and Expenses

Consolidated proposed to increase reported test-year pumping system - labor and expenses of \$3,604 by \$3,604 based upon having the plant operator visit the treatment plant daily rather than every other day as occurred during the test year. Consolidated stated that both the Commission and the Division of Water ("DOW") of the Kentucky Natural Resources and Environmental Protection ("KNREP") Cabinet require plant operators to visit treatment plants on a daily basis. According to the Commission's Engineering Division, which consulted with a DOW employee, neither the Commission nor DOW require daily visits to sewage treatment plants. Furthermore, the Commission's Engineering Division is of the

opinion that Consolidated's plant is being well maintained under the present maintenance schedule. Therefore, Staff recommends that the proposed adjustment be denied and has included annual pumping system - labor and expenses of \$3,604 for rate-making purposes.

Treatment System - Sludge Hauling

Consolidated reported no test-year sludge hauling expense, but proposed an annual expense of \$9,000. In support of its proposal, Consolidated provided a copy of a quotation from Mike Carter of Carter Farms in Franklin, Kentucky. Mr. Carter agreed to haul one 6,000 gallon tank of sludge from Consolidated's treatment plant to Franklin, Kentucky for \$750 each month.

Consolidated submitted a copy of an invoice from William E. Riley Septic Tank Cleaning for \$810 which shows that 18 loads of sludge, at \$45 per load for 1,500 gallons, were hauled in June 1992. According to Consolidated, sludge is currently taken to a landfill in Daviess County, but sometime in the future, that landfill will no longer be permitted to receive sludge.

Staff spoke with an employee of the Division of Waste Management of the KNREP Cabinet regarding Consolidated's sludge hauling situation. That person said that he is not aware of the Daviess County landfill's inability to receive sludge in the near future. He also suggested that if the Daviess County landfill should become unable to receive sludge, Consolidated might explore the alternative of having sludge hauled to a landfill in Ohio

County which would be much closer than Franklin, Kentucky which is approximately 90 miles from Owensboro.

Based on the preceding discussion, Staff recommends that annual sludge hauling expense of \$810 be included for rate-making purposes.

Treatment System - Labor and Expenses

Consolidated proposed to increase reported test-year treatment system - labor and expenses of \$2,398 by \$2,398 based upon having the plant operator visit the treatment plant daily rather than every other day. As mentioned previously in the section on pumping system - labor and expenses, neither the Commission nor DOW require daily visits to sewage treatment plants. Therefore, Staff recommends that the proposed adjustment be denied and has included annual treatment system - labor and expenses of \$2,398 for rate-making purposes.

Customer Records and Collection Expense

Consolidated proposed to increase reported test-year customer records and collection expense of \$4,696 by \$95 to reflect the year-end number of customers and the additional bills associated with the increase in customers. Staff is of the opinion that Consolidated's proposed adjustment is reasonable and recommends that annual customer records and collection expense of \$4,791 be included for rate-making purposes.

Administrative and General Salaries

Consolidated reported test-year administrative and general salaries of \$18,000, \$8,000 of which went to Consolidated's president, Ed Sheriff and \$10,000 of which went to the utility's secretary, Bruce Peters. Mr. Sheriff is employed on a full-time basis by Green River RECC, while Mr. Peters owns a construction company.

Mr. Sheriff and Mr. Peters are both involved with Consolidated in a management capacity and in a previous section of this report, Staff recommended an annual management fee of \$2,400 for rate-making purposes. Test-year payments totaling \$6,002 were made to Bruce Sheldon who provided maintenance services of a routine nature. Consolidated reported test-year charges of \$27,834 for maintenance services of a non-routine nature. Of that amount, \$16,779 was paid to Peters Construction Company.

In cases involving sewer utilities, the Commission generally has used the operating ratio method in the determination of revenue requirements. That method provides for a margin over and above operating expenses and allows Consolidated's owners to recover their investment. Therefore, because of the allowance of a margin as well as the allowance of the above-mentioned fees and payments, Staff recommends that test-year administrative and general salaries of \$18,000 be excluded for rate-making purposes.

Office Supplies and Other Expense

Consolidated reported test-year office supplies and other expenses of \$521. Of that amount, \$378 represents expenses incurred at Owensboro Country Club such as food and bar charges and golf cart fees. Staff is of the opinion that those charges were of no benefit to Consolidated's customers and should be excluded for rate-making purposes. Therefore, Staff recommends inclusion of annual office supplies and other expense of \$143 for rate-making purposes.

Miscellaneous General Expense

Consolidated reported test-year miscellaneous general expense of \$4,900. A breakdown of charges to that account showed that both Mr. Sheriff and Mr. Peters received a director's fee of \$2,400. As mentioned in a previous section of this report, Staff recommended a management fee of \$2,400. Therefore, Staff recommends that directors' fees of \$4,800 be excluded for rate-making purposes and has included annual miscellaneous general expense of \$100 for rate-making purposes.

Depreciation Expense

Consolidated proposed to reduce reported test-year depreciation expense of \$47,783 by \$41,788 to exclude \$45,026 of depreciation on contributed property and to include depreciation on 2 new mechanical aerators (\$2,000) and to recognize a full year's depreciation on non-contributed plant added during the test year which requires an adjustment of \$1,238.

In support of the portion of its proposed adjustment associated with the 2 new aerators, Consolidated submitted a copy of a price quotation from Peters Contracting which shows a total price of \$16,000. Consolidated has proposed to depreciate the aerators over 8 years, a period considered reasonable by the Commission's Engineering Division.

Staff reviewed Consolidated's calculation of the proposed adjustment of \$1,238 to recognize a full year's depreciation on several items of plant added during the test year and found it to be reasonable. Since Staff considers all portions of the proposed adjustment to be reasonable, annual depreciation expense of \$5,995 has been included for rate-making purposes.

Amortization Expense

Consolidated proposed an annual expense of \$1,750 based upon amortizing estimated rate case expense of \$5,250 over 3 years which is the Commission's normal practice. Staff does recommend that rate case expense be amortized over 3 years, but also recommends that only rate case expense actually incurred be used in calculating the annual expense. Since Consolidated submitted copies of invoices totaling \$3,243, annual rate case expense of \$1,081 has been included for rate-making purposes.

Taxes Other Than Income Tax

Consolidated proposed to increase reported test-year taxes other than income tax expense of \$4,021 by \$2,634 to reflect property tax on the 2 new aerators (\$119) and on other plant added

during the test year (\$2,515). Staff is of the opinion that the proposed adjustment is reasonable and recommends inclusion of annual taxes other than income tax expense of \$6,655 for rate-making purposes.

Interest on Long-Term Debt

Consolidated proposed to include interest expense on long-term debt of \$1,313 which represents the first year's interest on debt incurred to finance the purchase of 2 new aerators. For rate-making purposes, Staff recommends using the average annual interest expense over the term of the loan. Therefore, annual interest expense on long-term debt of \$817 has been included for rate-making purposes.

Interest on Debt to Associated Companies

Consolidated reported test-year interest expense on debt to associated companies of \$1,298. According to Consolidated, the proceeds of this debt were used for working capital. In past cases, the Commission has not allowed interest expense on debt incurred to finance current operations. Therefore, Staff recommends that no interest expense on debt to associated companies be included for rate-making purposes.

Miscellaneous Deductions

Consolidated proposed to exclude miscellaneous deductions of \$1,560 which represent payment of dues to Owensboro Country Club. Staff agrees that this expense should be excluded and, therefore,

recommends that no miscellaneous deductions be included for rate-making purposes.

Operations Summary

Based on the recommendations of Staff contained in this report, Consolidated's operating statement would appear as follows:

	<u>Test Year Actual</u>	<u>Recommended Adjustments</u>	<u>Test Year Adjusted</u>
OPERATING REVENUES:			
Sewage Service Revenues	\$107,284	\$ 0	\$107,284
Other Oper. Revenues	7,800	<7,800>	0
Total Oper. Revenues	<u>\$115,084</u>	<u>\$ <7,800></u>	<u>\$107,284</u>
OPERATING EXPENSES:			
Management Fee	\$ 0	\$ 2,400	\$ 2,400
Pumping System - Labor & Expenses	3,604	0	3,604
Treatment System - Sludge Hauling	0	810	810
Treatment System - Labor & Expenses	2,398	0	2,398
Electric Power	29,985	0	29,985
Chemicals	1,485	0	1,485
Maintenance	27,834	0	27,834
Customer Records & Coll. Uncollectible Accounts	4,696	95	4,791
Admin. & Gen. Salaries	18,000	<18,000>	0
Office Supplies & Other	521	<378>	143
Outside Services	971	0	971
Insurance	1,431	0	1,431
Misc. General	4,900	<4,800>	100
Main. of Gen. Plant	26	0	26
Depreciation	47,783	<41,788>	5,995
Amortization	0	1,081	1,081
Taxes Other Than Income	4,021	2,634	6,655
Total Income Taxes - Operating Income	29	0	29
Total Oper. Expenses	<u>\$148,304</u>	<u>\$ <57,946></u>	<u>\$ 90,358</u>
NET OPERATING INCOME	\$ <33,220>	\$ 50,146	\$ 16,926
OTHER INCOME - Interest & Dividend	141	0	141

OTHER DEDUCTIONS:

Int. on Long-Term Debt	0	817	817
Int. on Debt to Assoc. Companies	1,698	<1,698>	0
Misc. Deductions	<u>1,560</u>	<u><1,560></u>	<u>0</u>
NET INCOME	<u>\$<36,337></u>	<u>\$ 52,587</u>	<u>\$ 16,250</u>

C. Revenue Requirements Determination

The approach frequently used by the Commission to determine revenue requirements for privately-owned utilities is the calculation of an operating ratio.¹

This approach is used primarily when there is no basis for a rate-of-return determination or due to the fact that the cost of the utility plant has fully, or largely, been recovered through the receipt of contributions, either in the form of grants or donated property. The ratio generally used by the Commission in order to provide for equity growth is 88 percent. In this instance, the use of an 88 percent after-tax operating ratio applied to the test-year operating expense plus allowing a dollar-for-dollar coverage of interest expense on long-term debt results in a total revenue

¹ Operating Ratio = Operating Expense/Operating Revenue.

requirement of \$106,275² which is less than the adjusted test-year revenues of \$107,284. Therefore, Staff recommends no increase in Consolidated's annual revenues.

D. Rate Design

Insofar that the Staff recommends no rate increase in this report, they further recommend that the rate design remain the same as that in effect at the present time.

² Adjusted Operating Expense/Operating Ratio	\$ 90,358/.88
Required Operating Revenue Exclusive of Provision for Income Taxes	\$102,680
Required Operating Revenue without Tax Provision	\$102,680
Less: Adjusted Operating Expense	<u><90,358></u>
Net Operating Income Exclusive of Provision for Income Taxes	\$ 12,322
Net Operating Income Exclusive of Provision for Income Taxes/Complement of Composite Tax Rate	\$ 12,322/.816
Net Operating Income Inclusive of Provision for Income Taxes	\$ 15,100
Adjusted Operating Expense	\$ 90,358
Add: Net Operating Income with Income Tax Provision	\$ 15,100
Add: Interest Expense on Long-Term Debt	<u>\$ 817</u>
Revenue Requirement Inclusive of Income Tax Provision	<u>\$106,275</u>

E. Signatures

Carl Salyer Combs
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Rates and Tariffs Division

Nicky Moore
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