

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF B & H, INC. FOR)
AN ADJUSTMENT OF RATES PURSUANT TO)
THE ALTERNATIVE RATE FILING PROCEDURE) CASE NO. 93-307
FOR SMALL UTILITIES)

O R D E R

On September 7, 1993, B & H, Inc. ("B & H") filed its application for Commission approval of proposed sewer rates. Commission Staff, having performed a limited financial review of B & H's operations, has prepared the attached Staff Report containing Staff's findings and recommendations regarding the 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.

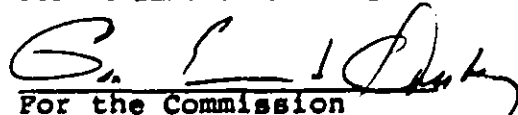
IT IS THEREFORE ORDERED that all parties shall have no more than 15 days from the date of this Order to provide written comments regarding the attached Staff Report or requests for a hearing or informal conference. If no request for a hearing or informal conference is received, this case will be submitted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

Done at Frankfort, Kentucky, this 8th day of November, 1993.

ATTEST:


Executive Director

PUBLIC SERVICE COMMISSION


For the Commission

COMMONWEALTH OF KENTUCKY
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STAFF REPORT

Prepared By: Karen S. Harrod, CPA
Public Utility Financial
Analyst, Chief
Water and Sewer Revenue
Requirements Branch
Division of Financial Analysis

Prepared By: Nicky Moore
Public Utility Rate
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Division of Rates and Research

STAFF REPORT

ON

B & H, INC.

CASE NO. 93-307

A. Preface

On August 25, 1993, B & H, Inc. ("B & H") submitted its application with the Kentucky Public Service Commission ("Commission") seeking approval to increase its tariffed sewer rates by 77 percent, an increase in annual operating revenues of \$21,958. The application was considered filed on September 7, 1993, when all deficiencies were cured.

In order to evaluate the requested increase, the Commission Staff ("Staff") would ordinarily perform a limited financial review of the utility's operations for the test period, the twelve month period ending December 31, 1992. However, in this instance, B & H requested and received Staff assistance in preparing its application. As a result, the field review procedures were performed prior to the filing of the application. Karen Harrod, of the Commission's Division of Financial Analysis conducted the review on July 2, 1993 at B & H's office, in Richmond, Kentucky. Nicky Moore of the Commission's Division of Rates and Research performed a review of B & H's reported revenues at the Commission's office in Frankfort, Kentucky.

The findings of Staff's review have been reduced to writing in this report. Mr. Moore is responsible for the sections related to operating revenues and rate design. The remaining sections of the report were prepared by Ms. Harrod. Based upon the findings contained herein, Staff recommends that B & H be allowed to increase its annual operating revenues by the proposed amount of \$21,958.

Scope

The scope of the review was limited to obtaining information to determine whether test period operating revenues and expenses were representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed in this report.

During the course of the review, B & H was advised that all proposed adjustments to test year expenses must be supported by some form of documentation and that all such adjustments must be known and measurable.

B. Analysis of Operating Revenues and Expenses

Operating Revenue

B & H reported test-year operating revenue from rates of \$28,669 and miscellaneous revenue of \$699. Staff made no adjustments to revenue from rates or other operating revenue. Therefore, for the purpose of this report, normalized test-year operating revenue shall be considered to be \$29,368.

Operating Expenses

In its application B & H reported operating expenses of \$33,024 for the test year. The pro-forma adjustments to test period expenses are discussed in the following sections of this report.

Sewer Analysis

For the test period B & H reported sewer analysis/testing expense of \$5,262. An adjustment was proposed to increase this amount by \$1,146 based on the current monthly expense being incurred by B & H for this purpose. Staff is of the opinion that this adjustment is known and

measurable and should be allowed for rate-making purposes. Therefore, an adjustment has been included to increase sewer analysis expense to a pro forma level of \$6,408.

Routine Maintenance

B & H reported routine maintenance expense of \$1,656 for the test year. An adjustment was proposed to increase this expense by \$4,168 to reflect the current level of expense. According to information provided by B & H, the utility is required by the Division of Water to have an operator at the plant at least two hours per day. Based on the current salary paid to B & H's operator of \$8.00 per hour the current level of expense would be \$5,824¹. Accordingly, Staff recommends this adjustment be allowed in the determination of B & H's revenue requirement.

Maintenance - Treatment & Disposal Plant

For the test year B & H reported \$7,381 of maintenance expense for the treatment and disposal plant. The expenses charged to this account are monies paid to Hager Cabinets, Inc. for monthly services provided to B & H as a result of a service agreement between the two entities. The services provided by Hager Cabinets, Inc. include office space, utilities, and various administrative services. An adjustment was proposed to decrease the test year level by \$61 to reflect the contract cost for these services of \$610 per month.

¹	\$16.00/day x 7 days	\$ 112	per week
	Annual expense	x 52	weeks
		<u>\$5,824</u>	

In B & H's previous case² the Commission allowed the monthly expense of \$610 for these services. It is Staff's opinion that this expense meets the rate-making criteria of being known and measurable and should be allowed. As a result Staff has included a pro forma level of maintenance expense of \$7,320 in B & H's adjusted operations.

Amortization Expense

B & H did not report any amortization expense in its test period operations. However, an adjustment was proposed to include amortization expense of \$2,409 in the determination of its revenue requirements. The adjustment was proposed to amortize the cost of a remedial action plan which B & H was required to obtain and implement as a result of an agreed order with the Division of Water. Based on an invoice reviewed by Staff, the initial cost of this plan was \$12,047. It was proposed, and Staff concurs, that this cost should be amortized over a period of five years resulting in an annual expense of \$2,409.

Staff is of the opinion that if such a plan is required for B & H to continue operating, the customers derive a benefit from this expense. Therefore, Staff recommends the proposed amortization expense be allowed.

² Case No. 90-223, THE APPLICATION OF B & H INCORPORATED FOR A RATE ADJUSTMENT PURSUANT TO THE ALTERNATIVE RATE FILING PROCEDURE FOR SMALL UTILITIES, Order dated December 20, 1990.

Taxes Other than Income Taxes

In its test year operations B & H included taxes other than income taxes expense of \$348. An adjustment was proposed to decrease this amount by \$94 to eliminate a duplicate payment of property taxes. Based on Staff's review the payment was made twice and subsequently refunded after the test year. As a result Staff has included the decrease in the calculation of B & H's adjusted operations.

Interest Expense

B & H reported test year interest expense of \$1,132 which it proposed to increase by \$2,747. This adjustment was based on the current interest being paid on B & H's outstanding debt. The debt was incurred for the purpose of meeting various operating and maintenance expenses of B & H and has a current balance of \$65,421. After deducting expenses of \$13,696 which were accounted for in the sewer analysis and amortization expense sections of this report, B & H has outstanding indebtedness of \$51,725. The demand note for this debt requires interest payments based on the prime rate plus 1 1/2 percent. Based on a prime rate of 6 percent, B & H's annual interest expense would be \$3,879, or \$2,747 more than the test year level. Staff is of the opinion that this should be allowed for rate-making purposes and has included interest expense of \$3,879 in B & H's test year operations.

Operations Summary

Based on the recommendations of Staff, B & H'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 an 88 percent operating ratio. Staff recommends the use of this approach in determining B & H's revenue requirement. Therefore, Staff recommends that B & H be allowed to increase its annual revenues by the proposed amount of \$21,958, calculated as follows:

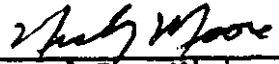
Adjusted Operating Expenses	\$ 40,592
Operating Ratio	+ .88
Required Operating Revenue before Income Taxes	<u>\$ 46,127</u>
Less: Adjusted Operating Expenses	<u>40,592</u>
Revenue Subject to Income Taxes	\$ 5,535
Gross-up Factor	<u>1.23839</u>
Net Operating Income Inclusive of Provision for Income Taxes	\$ 6,855
Add: Adjusted Operating Expenses	40,592
Interest Expense	<u>3,879</u>
Revenue Requirement	\$ 51,326
Less: Normalized Test-Year Revenue	<u>29,368</u>
Required Revenue Increase	<u>\$ 21,958</u>

D. Rate Design

In its application, B & H filed a schedule of present and proposed rates that did not include any changes in its rate design. Staff agrees that the current rate structure should not be altered. The recommended rates in Appendix A will generate operating revenue of \$50,627. The revenue from rates and miscellaneous revenue in the amount of \$699 will produce the total operating revenue requirement of \$51,326. Therefore, Staff recommends that the rates in Appendix A be approved for sewer service.

E. Signatures


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Requirements Branch
Division of Financial Analysis


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Public Utility Rate
Analyst
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Sewer Rate Design Branch
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APPENDIX A
TO STAFF REPORT CASE NO. 93-307

The Staff recommends the following rate be prescribed for customers of B & H, Inc.

Multi-family Units	\$ 22.80 monthly
Single-family Units	\$ 30.10 monthly

APPENDIX B
TO STAFF REPORT CASE NO. 93-307

B & H, Inc.
Statement of Adjusted Operations
Test Year Ended 12/31/92

	<u>Test Year</u>	<u>Recommended Adjustments</u>	<u>Test Year Adjusted</u>
Operating Revenues:			
Sewer Revenues	\$ 31,511	(\$ 2,842)	\$ 28,669
Miscellaneous Revenues	<u>699</u>		<u>699</u>
Total Operating Revenues	\$ 32,210	(\$ 2,842)	\$ 29,368
Operating Expenses:			
Pumping System Expense	256		256
Treatment System Expense	5,050		5,050
Sludge Hauling	6,064		6,064
Water Expense	386		386
Sewer Analysis	5,262	1,146	6,408
Purchased Power	2,088		2,088
Chemicals	1,936		1,936
Freight	168		168
Routine Maintenance	1,656	4,168	5,824
Maintenance-Treatment & Disposal	7,381	(61)	7,320
Office Supplies & Other	390		390
Reg. Commission Expense	50		50
Outside Services	1,918		1,918
Bank Charges	71		71
Amortization Expense	-0-	2,409	2,409
Taxes Other than Income Taxes	<u>348</u>	<u>(94)</u>	<u>254</u>
Total Operating Expenses	<u>\$ 33,024</u>	<u>\$ 7,568</u>	<u>\$ 40,592</u>
Operating Income	(\$ 814)	(\$ 10,410)	(\$ 11,224)
Interest Expense	<u>1,132</u>	<u>2,747</u>	<u>3,879</u>
Net Income/(Loss)	<u>(\$ 1,946)</u>	<u>(\$ 13,157)</u>	<u>(\$ 15,103)</u>