

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF HERRINGTON HAVEN)
WASTEWATER COMPANY FOR A RATE)
ADJUSTMENT PURSUANT TO THE ALTERNATIVE) CASE NO. 96-317
RATE FILING PROCEDURE FOR SMALL UTILITIES)

O R D E R

On July 8, 1996, Herrington Haven Wastewater Company ("Herrington Haven") filed its application for Commission approval of proposed sewer rates. Commission Staff, having performed a limited financial review of Herrington Haven'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, or 90 days after the date the application was filed, whichever is later, 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 23rd day of September, 1996.

ATTEST:


Executive Director

PUBLIC SERVICE COMMISSION


For the Commission

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF HERRINGTON HAVEN)
WASTEWATER COMPANY, INC. FOR A RATE)
ADJUSTMENT PURSUANT TO THE ALTERNATIVE) CASE NO. 96-317
RATE FILING PROCEDURE FOR SMALL UTILITIES)

STAFF REPORT

Prepared By: Carl Salyer Combs
Public Utility Financial
Analyst, Senior
Water and Sewer Revenue
Requirements Branch
Financial Analysis Division

Prepared By: Christopher H. Smith
Public Utility Rate Analyst
Communications, Water and
Sewer Rate Design Branch
Rates and Research Division

STAFF REPORT

ON

CASE NO. 96-317

A. Preface

On July 8, 1996, Herrington Haven Wastewater Company, Inc. ("Herrington Haven") filed an application with the Commission seeking to increase its sewer rate pursuant to the Alternative Rate Filing Procedure for Small Utilities. The proposed rate would generate approximately \$4,317 annually in additional revenues, an increase of 109 percent over normalized test-year revenues of \$3,960.

In order to evaluate the requested increase, the Commission Staff ("Staff") chose to perform a limited financial review of Herrington Haven's operations for the test period, calendar year 1995. Since Herrington Haven requested and received Staff assistance in preparing this application, the field review was done prior to the filing of the application. Carl Salyer Combs conducted the review on May 17, 1996, at the home of Melvin Price, Herrington Haven's owner, since Herrington Haven has no office other than the one maintained in Mr. Price's home. Mr. Combs is responsible for this Staff Report except for the sections on operating revenues and rate design which were prepared by Christopher H. Smith of the Commission's Division of Rates and Research.

During the course of the review, Herrington Haven was informed 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 Herrington Haven be authorized to increase its annual operating revenues by \$3,614.

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

Herrington Haven's 1995 annual report indicates that it had revenue from rates during the test period of \$1,980. The revenue amount represents collections over a six-month period, since Mr. Price assumed ownership of the utility and began operations on July 1, 1995. A calculation of its revenue from rates for 1995 based on its year-end number of customers (22 customers x \$15 per month x 12 months) yields a normalized revenue figure of \$3,960, a difference of \$1,980 over reported test period revenue.

Operating Expenses

Herrington Haven incurred, and the Staff-assisted application included, test-period operating expenses of \$4,395. Herrington Haven proposed to increase that amount by \$2,889. Herrington Haven's proposed adjustments and Staff's recommendations are discussed in the following sections:

Management/Routine Maintenance Fee

Herrington Haven reported no test-period management fee, but proposed an annual fee of \$3,600. Herrington Haven views the proposed management fee as compensation

for both management duties and provision of routine maintenance services by its owner/operator, Melvin Price. The Commission's normal practice in cases involving small sewer utilities is to allow an annual management fee. The management duties of Herrington Haven's manager are comparable to the general oversight responsibilities of a water district commissioner. According to KRS 74.020 (6), a water district commissioner shall receive annual compensation of not more than \$3,600. When informed that such compensation has been allowed by the Commission in previous cases, Herrington Haven elected to request an annual management fee of \$3,600. Therefore, Staff has included an annual management/routine maintenance fee of \$3,600 for rate-making purposes.

Supervision & Engineering - Other Expense

Herrington Haven reported test-period supervision & engineering - other expenses of \$454. This charge represents fees paid to an attorney to incorporate. Staff is of the opinion that such an expense should be amortized over a three-year period. Therefore, the charge of \$454 has been excluded from this account and \$151¹ has been included in amortization expense for rate-making purposes.

Labor - Collection System

Herrington Haven proposed to eliminate reported test-period labor - collection system expense of \$22 due to the proposed inclusion of an annual management fee of \$3,600 to compensate the sewer system's operator and due also to the insignificance of the amount of the test-period charges to this account. Staff is of the opinion that the

¹ \$454/3 years = \$151

proposed adjustment is reasonable and recommends that no annual labor - collection system expense be included for rate-making purposes.

Sludge Hauling Expense

Herrington Haven proposed to increase reported test-period sludge hauling expense of \$130 by a like amount due to the fact that test-period expenses represent only six months of operation. \$130 of sludge hauling expense equates to two loads of sludge. Larry Updike, a sewer utility inspector with the Commission's Engineering Division, is of the opinion that Herrington Haven's proposal to have four loads of sludge hauled annually is a reasonable amount. Therefore, Staff recommends inclusion of annual sludge hauling expense of \$260 for rate-making purposes.

Electric Power Expense

Herrington Haven proposed to increase reported test-period electric expense of \$249 by \$291 based upon four invoices from Kentucky Utilities for the period of December 20, 1995 through April 22, 1996. The proposed annual electric expense averages \$45 per month. The aforementioned invoices viewed by Staff at the time of the field review showed an average of \$46.10 for the four-month period. Therefore, Herrington Haven has supported an annual electric expense of \$540, and Staff recommends inclusion of that amount for rate-making purposes.

Chemicals Expense

Herrington Haven proposed to increase reported test-period chemicals expense of \$58 by \$62 based upon the fact that the \$58 expense represents usage for only six months of the test year. Larry Updike is of the opinion that annual chemicals expense of \$120 is

reasonable, and Staff recommends inclusion of annual chemicals expense of \$120 for rate-making purposes.

Routine Maintenance Fees

Herrington Haven reported test-period routine maintenance expense of \$180, but the fees were paid for testing. Staff recommends that these fees be reclassified to Account No. 923 -- Outside Services Employed. As mentioned previously in the management/routine maintenance fee section, Staff included, for rate-making purposes, an annual management/routine maintenance fee of \$3,600. Therefore, for rate-making purposes, Staff has included no fees in the account carrying the title "routine maintenance fees."

Maintenance of Structures and Improvements

Herrington Haven proposed to reduce reported test-period maintenance of structures and improvements expense of \$440 by \$40, stating at the time of the field review that \$400 annually should be an adequate amount on an ongoing basis. The reported \$440 was for expenses incurred during six months of the test period. Charges to this account are for maintenance expenses of a non-routine nature and include materials and labor costs associated with mechanical and/or equipment (blowers, motors, pulleys, timers, etc.) repairs. Staff is of the opinion that \$400 annually is a reasonable amount for non-routine maintenance and has included annual maintenance of structures and improvements expense of \$400 for rate-making purposes.

Administrative and General Salaries

Herrington Haven reported no test period administrative and general salaries, but proposed an annual salary of \$1,800 for its secretary/records clerk who has drawn no salary previously. The secretary/records clerk performs billing duties, makes bank deposits, and pays bills. Furthermore, that person also prepares the Public Service Commission ("PSC") annual report and tax returns for Herrington Haven, rather than having those done by a certified public accountant. Staff is of the opinion that an annual salary of \$600, or \$50 monthly, is a reasonable amount for the duties performed and recommends inclusion of annual administrative and general salaries expense of \$600 for rate-making purposes.

Outside Services Employed

Herrington Haven reported no outside services expense for the test period. As mentioned previously in the section on routine maintenance fees, Staff recommended that testing fees be reclassified to this account. Reported test fees of \$180 were for six months of the test period. Therefore, Herrington Haven proposed an adjustment of \$180 to reflect a full year's testing expense at \$90 per quarter. Staff is of the opinion that the proposed adjustment is reasonable and recommends inclusion of annual outside services expense of \$360 for rate-making purposes.

Transportation Expense

Herrington Haven proposed to eliminate, for rate-making purposes, reported test period transportation expense of \$2,500 due to the fact that Mr. Price now lives next to the sewage treatment plant. Staff is of the opinion that the proposed adjustment to eliminate

transportation expense for rate-making purposes is reasonable, and therefore, has included no annual transportation expense for rate-making purposes.

Depreciation Expense

Herrington Haven reported no test period depreciation expense, but proposed annual depreciation expense of \$619² based upon an estimated value of \$9,285 for the plant and service lines and an estimated remaining life of 15 years. No annual reports were filed for the four years prior to 1995, the year in which Mr. Price assumed ownership of Herrington Haven. According to Mr. Price, he consulted Ed Pence, the original developer of Herrington Haven subdivision, regarding the original cost of the treatment plant and service lines. According to Mr. Pence's recollection, the original cost was approximately \$22,000 - \$24,000. Mr. Price chose to record on Herrington Haven's balance sheet in its 1995 annual report the conservative figure of \$20,000 for the cost of the utility plant. In the opinion of Mr. Price, the treatment plant has a current value of \$4,285, while the service lines have a current value of \$5,000.

According to the 1979 annual report (the first ever filed with the Commission for Herrington Haven) filed on behalf of the utility by Roy Franklin, a former owner of Herrington Haven (formerly named Franklin Sewer Company, Inc.), the utility began operations on September 17, 1975, although the plant originally had been constructed in 1964. The balance sheet in the 1979 annual report showed a gross utility plant amount of \$3,500 with no accumulated depreciation. The income statement for that same year

² \$9,285/15 years = \$619 annually

showed no depreciation expense. Furthermore, the 1979 annual report also contained a response asserting that one hundred percent of the cost of the treatment plant had been recovered by the developer through the sale of lots. Therefore, staff is of the opinion that the original plant should be considered contributed property, and no annual depreciation expense has been included for rate-making purposes.

Amortization Expense

Herrington Haven reported no test period amortization expense, but proposed annual amortization expense of \$401³ based upon: (1) the cost of incorporation (\$454) spread over three years; (2) the cost for tank fabrication (\$500) spread over 10 years; and (3) the cost of a Kentucky Pollution Discharge Elimination System (\$1,000) spread over five years. Staff is of the opinion that the proposed adjustment is reasonable and has included annual amortization expense of \$401 for rate-making purposes.

Operations Summary

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

³ Incorporation expense (\$454/3 years)	\$151
Tank fabrication cost (\$500/10 years)	50
KPDES Permit cost (\$1,000/5 years)	<u>200</u>
Total Amortization Expense	<u>\$401</u>

	<u>Test Period Application</u>	<u>Recommended Adjustments</u>	<u>Test Year Adjusted</u>
REVENUES			
Sewer Revenues	\$ 1,980	\$ 1,980	\$ 3,960
OPERATING EXPENSES:			
Mgmt. Fee	\$ -0-	\$ 3,600	\$ 3,600
Supervision- Other Exp.	454	(454)	-0-
Labor-Collect. System	22	-0-	22
Sludge Hauling	130	130	260
Electric Power	249	291	540
Chemicals	58	62	120
Routine Maint. Maint./Struct.	180	(180)	-0-
& Improvements	440	(40)	400
Customer Records	60	-0-	60
Admin. & General Salaries	-0-	600	600
Office Supplies	202	-0-	202
Outside Services- Testing	-0-	360	360
Transportation	2,500	(2,500)	-0-
Depreciation	-0-	-0-	-0-
Amortization	-0-	401	401
Taxes Other Than Income Taxes	<u>100</u>	<u>-0-</u>	<u>100</u>
Total Exp.	<u>\$ 4,395</u>	<u>\$ 2,270</u>	<u>\$ 6,665</u>
Revenue Less Expense	<u>\$(2,415)</u>	<u>\$(290)</u>	<u>\$(2,705)</u>

C. Revenue Requirements Determination

The approach frequently used by the Commission to determine revenue requirements for small, privately-owned utilities is the calculation of an operating ratio.⁴ 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 been recovered fully, or largely, through the receipt of contributions, either in the form of grants or donated property. As Herrington Haven fits this description, Staff recommends use of an operating ratio for determining revenue requirements. The ratio generally used by the Commission in order to provide for equity growth is 88 percent. For utilities subject to federal and state income taxes, an additional allowance is provided to cover those obligations. Since Herrington Haven was established as a S corporation, no provision has been made for income taxes. In this instance, use of an 88 percent operating ratio applied to the adjusted test-period operating expense results in a total revenue requirement of \$7,574 and increased revenues of \$3,614⁵. Therefore, Staff recommends an increase of \$3,614 in annual revenues.

⁴ Operating Ratio = Operating Expense / Operating Revenue

⁵ Adjusted Test-Period Expense / Operating Ratio	\$6,665 / .88 =
Total Revenue Requirement	\$7,574
Total Revenue Requirement	\$7,574
Less: Adjusted Test-Period Revenues	(3,960)
Amount of Increase Required	<u>\$3,614</u>

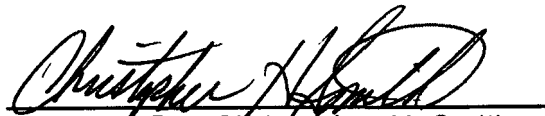
D. Rate Design

In its application, Herrington Haven filed a schedule of present and proposed rates. Staff is of the opinion that the present flat rate design is reasonable. Herrington Haven did not propose to change its present rate design, therefore, any change in revenue in this case will be added to or subtracted from the existing rate structure. The rate set out in Appendix A will produce \$7,574 annually.

E. Signatures



Prepared By: Carl Salyer Combs
Public Utility Financial
Analyst, Senior
Water and Sewer Revenue
Requirements Branch
Financial Analysis Division



Prepared By: Christopher H. Smith
Public Utility Rate Analyst
Communications, Water and
Sewer Rate Design Branch
Rates and Research Division

APPENDIX A
TO STAFF REPORT CASE NO. 96-317
HERRINGTON HAVEN WASTEWATER COMPANY, INC.

The following rate is recommended for the customers served by Herrington Haven
Wastewater Company, Inc.

Monthly Rate:

\$ 28.70