COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF BIG BEAR WASTEWATER, INC. FOR AN ADJUSTMENT OF RATES PURSUANT TO THE ALTERNATIVE RATE FILING PROCEDURE FOR SMALL UTILITIES	)	CASE NO. 97-245

ORDER

On May 7, 1997, Big Bear Wastewater, Inc. ("Big Bear") filed its application for Commission approval of proposed rates. Commission Staff, having performed a limited financial review of Big Bear'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 requests for a hearing no later than 10 days from the date of this Order.

IT IS THEREFORE ORDERED that all requests for a hearing shall be filed no later than 10 days from the date of this Order. If no requests are received, this case will be submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this 11th day of February, 1998.

ATTEST:

Helen C. Helton

Executive Director

PUBLIC SERVICE COMMISSION

B. J. Helton

For the Commission

COMMONWEALTH OF KENTUCKY
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STAFF REPORT

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Analyst, Chief
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Requirements Branch
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STAFF REPORT

ON

BIG BEAR WASTEWATER, INC

CASE NO. 97-245

A. Preface

On May 7, 1997, Big Bear Wastewater, Inc. ("Big Bear") submitted an application seeking to increase its rates pursuant to 807 KAR 5:076, the Alternative Rate Adjustment Procedure for Small Utilities. Big Bear requested and received Commission Staff ("Staff") assistance in preparing its application. The rates proposed by Big Bear would produce additional annual sewer revenues of $10,769, an increase of 68.1 percent over Staff's normalized test-period sewer revenues of $15,820.

In accordance with 807 KAR 5:076, Section 1, the test-period is the immediate past year from the date the application was filed, the calendar year 1996. In order to evaluate the requested sewer rate increase, Staff reviewed Big Bear's actual and pro forma operations contained in the application. The Commission issued an Information Order on October 30, 1997, which Big Bear responded to on November 12, 1997.

Mark Frost of the Commission's Division of Financial Analysis is responsible for the preparation of this Staff Report except for the determination of Normalized Operating Revenue, Rate Design, and Appendix A, which were prepared by Carryn Lee of the same division. Based on the findings contained in this report, Staff recommends that Big Bear be granted an increase in sewer revenues of $5,939.

Scope

The scope of the review was limited to obtaining information to determine whether the 1996 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

Normalized Operating Revenue

Big Bear reported test year revenues from sewer collections in the amount of $11,180. Big Bear currently serves 34 units at a monthly rate of $21.90 and one unit at a monthly rate of $26.20. Staff has adjusted test year revenue to reflect the current number of units served at the current tariffed rate. Based on these adjustments the test year revenue amount used in this report is $15,819.

Loan

During the test-period, Big Bear received a $200 loan from Janet Caldemeyer, which it reported as an operating revenue. The payment of the loan principal and interest was recorded in test-period operating expenses. To eliminate the non-recurring loan from its test-period operations, Big Bear proposed to reduce operating revenues and expenses by $200 and $236, respectively.

For rate-making purposes, non-recurring items are removed from test-period operations in order to obtain a utility's normal operations. Accordingly, Staff recommends the proposed adjustments be accepted.

Operating Expenses

In its application, Big Bear reported actual and pro forma test-period operating expenses of $10,209 and $33,781, respectively. The following are Staff's recommended adjustments to Big Bear's actual test-period operations and discussions of the proposed pro forma adjustments:

Owner/Manager Fee: Big Bear did not incur an owner/manager fee during the test period; however it did propose to include a $3,600 fee in its pro forma operations. The proposed owner/manager fee is to compensate Rick Mier as Big Bear's owner/manager. The management duties performed by Mr. Mier are comparable to the general oversight responsibilities of a water district commissioner. According to KRS 74.020 (6), a water district commissioner may receive an annual salary of not more than $3,600. Given the similarities between the two positions, Staff is of the opinion that an owner/manager fee of $3,600 is reasonable and recommends that Big Bear's proposed adjustment be accepted.

Salary: Big Bear proposed a pro forma level of salary expense of $8,790, an increase of $6,690 above its test-period amount of $2,100. The following are Big Bear's 5 part-time employees: Robert Eastham, Supervisor of Operations; Dick Eastham, Assistant Supervisor of Operations; Jerry Ontiveros, Grounds Maintenance; Rhonda Brandon, Office Employee; and Janet Caldemeyer, Bookkeeper. Big Bear's employees are full-time employees of affiliated companies. Big Bear's proposed 318.6 percent increase in salary expense is attributed to estimates of the amount of time each employee currently spends performing services for Big Bear.

In 1996 Big Bear paid Robert Eastham a salary of $125 per month or $1,500 annually, which Big Bear has proposed to increase by 124.7 percent or $1,870. According to Big Bear, Robert Eastham spends approximately 23.25 hours per month performing the following tasks: 5 hours delivering tests to McCoy & McCoy; 10.25 hours on Public Service Commission and EPA materials and paperwork; 5 hours on the computer; and 3 hours at the treatment plant. However, the time sheets provided by Big Bear showed that between May 1997 and October 1997, Robert Eastham only spent 3 hours at the treatment plant for an average of 0.5 hours per month.

Big Bear was advised that the Commission uses the rate-making criteria of "known and measurable" to evaluate pro forma adjustments. An adjustment based on documented cost increase would constitute a known and measurable adjustment. In this instance, Big Bear failed to document its estimate of the time Robert Eastham spends performing duties for Big Bear. Using the time sheets provided by Big Bear and the current hourly rate of $15.68, Staff determined that Robert Eastham's annual salary would be $94, which is $1,406 less than the amount Big Bear reported in 1996. Accordingly, Staff recommends that salary expense be decreased by $1,406.

Big Bear proposed to increase test-period salary expense by $2,676 to reflect paying for the services of Dick Eastham. Upon its review of the May 1997 through October 1997 time sheets, Staff determined that Dick Eastham worked approximately

147 hours, which translates into 294 hours on an annual basis. Using the 294 annual hours and Dick Eastham's hourly rate of $12.02, Staff determined that Dick Eastham's salary would be $3,534, $678 above the level Big Bear proposed.

Because the number of hours Dick Eastham worked at the treatment plant is documented, an adjustment to reflect his salary in pro forma operating expenses would meet the rate-making criteria of known and measurable. Accordingly, Staff recommends Big Bear's test-period salary expense be increased by $3,534.

In 1996 Big Bear paid Rhonda Brandon a flat monthly salary of $50 or $600 annually, which Big Bear proposed to increase by 192.3 percent or $1,154. To justify its proposed increase Big Bear estimates that Rhonda Brandon works approximately 2 hours per week on its paperwork. However, as with Robert Eastham's proposed salary, Big Bear did not provide documentation to support its proposed increase, and therefore Staff recommends Big Bear's proposed adjustment to Rhonda Brandon's salary be denied.

Big Bear proposed to increase test-period salary expense by $390 to reflect paying Jerry Ontiveros an annual salary of $390 for grounds maintenance. However, Big Bear failed to document that Jerry Ontiveros spends 5 hours per month performing grounds maintenance for Big Bear. For this reason Staff recommends that Big Bear's proposed adjustment be denied.

Big Bear proposed to increase test-period salary expense by $1,200 to reflect paying Janet Caldemeyer a flat monthly salary of $100 to provide bookkeeping services.

Based upon past experience, Staff is of the opinion that a monthly bookkeeping fee of $100 is within a reasonable range for a utility of Big Bear's size and, therefore it recommends that Big Bear's adjustment be accepted.

Based on the aforementioned recommended adjustments, salary expense has been increased by $3,328.

FICA: Big Bear proposed a pro forma level of FICA expense of $1,223, an increase of $1,062 above its test period level of $161. This adjustment reflects the current FICA rate of 7.65 percent and Big Bear's proposed pro forma payroll of $15,990. Using its pro forma owner/manager fee and salary expense of $9,028 and the current FICA rate, Staff has determined that the pro forma FICA expense would be $691, an increase of $567 above the test-period amount. Therefore, Staff recommends that FICA tax expense be increased by $567.

KPDES Analysis: Big Bear proposed to increase its KPDES analysis expense of $469 to $704, an increase of $235. The amount Big Bear reported for the test period reflected paying McCoy & McCoy a testing fee of $58.65 for 8 months. This proposed adjustment reflects paying the testing fee for 12 months.

Big Bear provided a 1997 invoice from McCoy & McCoy showing that the testing fee increased from $58.65 to $62.25 per test. The increased testing fee results in an annual expense of $747,[1] $278 above Big Bear's test period level. Because an

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[1] $62.25 (Testing Fee) x 12 (Months) = $747.

adjustment to reflect the current KPDES testing fee would meet the rate-making criteria of known and measurable, Staff recommends the KPDES analysis expense be increased by $278.

Property Insurance: Big Bear did not incur a property insurance expense during the test period; however it did propose to include a premium of $576 in its pro forma operations. To document its proposed adjustment, Big Bear provided a letter from its insurance agent, which means the proposed adjustment meets the rate-making criteria of known and measurable. For this reason, Staff recommends Big Bear's adjustment be accepted.

Legal Fees: Big Bear proposed to reduce legal fee expense by $500 to eliminate non-recurring fees from its test-period operating expenses. Because, Big Bear's adjustment to remove non-recurring items from test-period operations is correct for rate-making purposes, Staff recommends the proposed adjustment be accepted.

Utilities: During the test-period, Big Bear Resorts, an affiliated company, paid Big Bear's telephone, garbage, and water services. Big Bear estimated that the minimum bill for each service would result in an annual expense of $716, which is the basis for this proposed adjustment.

Big Bear did not provide documentation to support its proposed adjustment, and therefore it fails to meet the known and measurable test. However, upon review of BellSouth's tariff, Staff determined that the telephone fee for basic business service for the Benton exchange is $28.10 per month, or $337 annually. Staff recommends that Big

Bear's proposed adjustment be denied and pro forma operating expenses be increased by $337 to reflect BellSouth's basic business fee.

Rent: Big Bear proposed to increase its pro forma expenses by $414 to reflect paying a truck and equipment rental fee to Big Bear Resorts. The proposed fees are based on Big Bear's estimated usage of the equipment.

Since this is a less-than-arms length transaction, it is important that all estimates and fees be documented. Big Bear failed to provide adequate documentation, and therefore the proposed adjustment does not constitute a known and measurable adjustment. Accordingly, Staff recommends that Big Bear's adjustment be denied.

Operations Summary

Based on Staff's recommendations contained in this report, Big Bear's pro forma operating statement would appear as set forth in Exhibit B to this report.

C. Revenue Requirement Determination

An 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 a rate-of-return determination or the cost of the utility has fully or largely been recovered through the receipt of CIAC. Staff recommends the use of this approach in determining Big Bear's revenue requirement.

Staff is of the opinion that Big Bear's requested operating ratio of 88 percent will provide a sufficient level of revenue to meet all of Big Bear's future expense obligations and to provide for a reasonable equity growth. An operating ratio of 88 percent and an allowance for the appropriate state and federal income taxes combined with Staff's proposed pro forma operations will result in a revenue requirement of $21,211,[2] an increase in sewer revenues of $5,392.[3]

D. Rate Design

Big Bear's current tariff provides for a monthly rate of $21.90 and $26.20 based on the number of fixture units. In reviewing the current rate design no information was provided to show that sewer usage for the customers of this particular utility was related to the number of fixtures. Based on a review of the expenses, Staff recommends that each unit be assessed a monthly rate of $29.50, which will produce the revenue requirement recommended herein.

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[2]

Staff's Pro Forma Operating Expenses	$ 18,174
Divided by: Recommended Operating Ratio	÷ 88%
Total Revenue Requirement	$ 20,652
Less: Staff Pro Forma Operating Exp.	- 18,174
Net Operating Income After Taxes	$ 2,478
Multiplied by: Tax Gross-Up Factor	x 1.2255
Net Operating Income Before Taxes	$ 3,037
Less: Staff's Pro Forma Operating Exp.	+ 18,174
Revenue Requirement from Rates	$ 21,211

[3]

Revenue Requirement from Rates	$ 21,211
Less: Normalized Operating Revenue	- 15,819
Revenue Increase	$ 5,392

E. Signatures

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APPENDIX B
TO THE STAFF REPORT CASE NO. 97-245

	Actual Test-Period Operations	Pro Forma Adjustments	Pro Forma Operations
Operating Revenues:			
Flat Rate - Commercial	$11,180	$4,639	$15,819
MLC Loan Proceeds	200	(200)	0
Total Operating Revenues	$11,380	$4,439	$15,819
Operating Expenses:			
Owner/Manager Fee	$0	$3,600	$3,600
Salary & Wages - Employees	2,100	3,328	5,428
FICA	124	567	691
Sludge Hauling	800	0	800
Maintenance	312	0	312
KPDES Analysis	469	278	747
Purchased Power	3,036	0	3,036
Chemicals	546	0	546
Office Supplies	208	0	208
Property Insurance	0	576	576
Legal Fees	1,106	(500)	606
Accounting Fees	875	0	875
Transportation	0	0	0
Miscellaneous	52	0	52
Permits/Certification	360	0	360
Equipment Rental	0	0	0
Utilities	0	337	337
Loan Repayment	200	(200)	0
Interest Expense	21	(21)	0
Total Operating Expenses	$10,209	$7,965	$18,174
Net Operating Income	$1,171	($3,526)	($2,355)