

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF ORCHARD GRASS)	
UTILITIES, INC. FOR A RATE ADJUSTMENT)	CASE NO. 97-458
PURSUANT TO THE ALTERNATIVE RATE)	
FILING PROCEDURE FOR SMALL UTILITIES)	

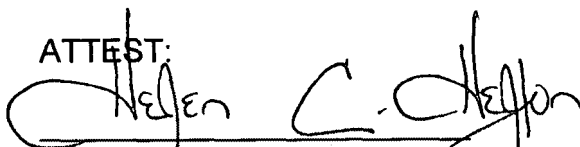
O R D E R

On December 10, 1997, Orchard Grass Utilities, Inc. ("Orchard Grass") filed its application for Commission approval of proposed sewer rates. Commission Staff, having performed a limited financial review of Orchard Grass'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 10 days from the date of this Order.

IT IS THEREFORE ORDERED that all parties shall have no more than 10 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 24th day of June, 1998.

ATTEST:


Executive Director

PUBLIC SERVICE COMMISSION


For the Commission

COMMONWEALTH OF KENTUCKY
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STAFF REPORT

Prepared by: Jack Scott Lawless, CPA
Auditor, Financial Audits Branch
Division of Financial Analysis

Prepared by: Renee Curry
Public Utility Rate Analyst
Communications, Water and Sewer
Rate Design Branch
Division of Financial Analysis

STAFF REPORT
ON
ORCHARD GRASS UTILITIES, INC.
CASE NO. 97-458

On December 10, 1997 Orchard Grass Utilities, Inc. ("Orchard Grass") filed its application seeking to increase its rates pursuant to 807 KAR 5:076. In order to evaluate the requested increase, Commission Staff ("Staff") performed a limited financial review of Orchard Grass's test period operations, the year ending December 31, 1996.

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

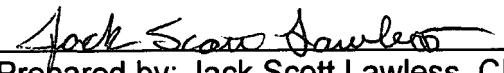
Scott Lawless of the Commission's Financial Audit Branch began the limited review on April 22, 1998. Mr. Lawless is responsible for the preparation of this Staff Report except for the determination of normalized operating revenue and Attachment D, which were prepared by Renee Curry of the Commission's Communication, Water, and Sewer Rate Design Branch.

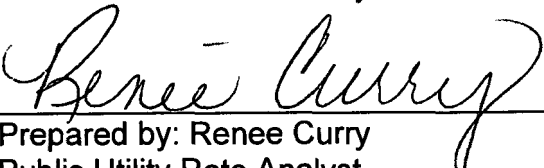
A comparison of Orchard Grass's actual and pro forma operations is shown in Attachment A. Based on Staff's recommendations, Orchard Grass's operating statement would appear as set forth in Attachment B.

Attachment C compares Orchard Grass's and Staff's revenue requirement calculations. Orchard Grass determined its pro forma revenue requirement to be \$117,999.05, an increase in revenues of \$54,932.05. Staff recommends a revenue

requirement of \$86,161.59 or a \$14,226.59 increase. The rates contained in Attachment D will achieve Staff's recommended level of revenue.

Signatures


Prepared by: Jack Scott Lawless, CPA
Auditor, Financial Audits Branch
Division of Financial Analysis


Prepared by: Renee Curry
Public Utility Rate Analyst
Communications, Water and Sewer
Rate Design Branch
Division of Financial Analysis

ATTACHMENT A
STAFF REPORT CASE NO. 97-458
ORCHARD GRASS'S REQUESTED OPERATIONS

	Test Year	Adjustments	Pro Forma Operations
Operating Revenues	\$ 63,067.00		\$ 63,067.00
Operation and Maintenance Expenses			
Management Fee	10,000.00		10,000.00
Sludge Hauling	9,214.00		9,214.00
Utility Service - Water Cost	3,681.00		3,681.00
Other - Labor	2,745.00	6,615.00	9,360.00
Fuel and Power	13,920.00		13,920.00
Chemicals	3,480.00		3,480.00
Routine Maintenance Fee	7,800.00	4,380.00	12,180.00
Maintenance of Collection System	2,738.00		2,738.00
Maintenance of Treatment Plant	12,548.00		12,548.00
Maintenance of Other Facilities	505.00		505.00
Agency Collection Fee	2,584.00		2,584.00
Office Supplies	225.00		225.00
Outside Services Employed	9,939.00	1,200.00	11,139.00
Insurance Expense	1,856.00		1,856.00
Regulatory Commission Expense	340.00		340.00
Transportation Expenses	1,912.00		1,912.00
Miscellaneous Expenses	1,680.00		1,680.00
Rents	600.00		600.00
Total Operation and Maintenance	85,767.00	12,195.00	97,962.00
Depreciation	515.00	2,009.00	2,524.00
Amortization		500.00	500.00
Taxes Other Than Income Taxes	1,153.00		1,153.00
Total Operating Expenses	87,435.00	14,704.00	102,139.00
Net Operating Income	(24,368.00)	(14,704.00)	(39,072.00)
Less: Interest Expense		(1,932.00)	(1,932.00)
Net Income	\$ (24,368.00)	\$ (16,636.00)	\$ (41,004.00)

ATTACHMENT B
STAFF REPORT CASE NO. 97-458
STAFF'S RECOMMENDED OPERATIONS

	Test Year	Adjustments	Pro Forma Operations
Operating Revenues	\$ 63,067.00	\$ 8,868.00 a	\$ 71,935.00
Operation and Maintenance Expenses			
Management Fee	10,000.00	(6,400.00) b	3,600.00
Sludge Hauling	9,214.00		9,214.00
Utility Service - Water Cost	3,681.00		3,681.00
Other - Labor	2,745.00	5,575.00 c	8,320.00
Fuel and Power	13,920.00		13,920.00
Chemicals	3,480.00		3,480.00
Routine Maintenance Fee	7,800.00	(300.00) d	7,500.00
Maintenance of Collection System	2,738.00		2,738.00
Maintenance of Treatment Plant	12,548.00		12,548.00
Maintenance of Other Facilities	505.00		505.00
Agency Collection Fee	2,584.00		2,584.00
Office Supplies	225.00		225.00
Outside Services Employed	9,939.00	(1,247.00) e (564.00) f (2,075.00) g (3,000.00) h	3,053.00
Insurance Expense	1,856.00	(1,120.00) i	736.00
Regulatory Commission Expense	340.00		340.00
Transportation Expenses	1,912.00	(1,912.00) j	0.00
Miscellaneous Expenses	1,680.00	(986.80) k	693.20
Rents	600.00		600.00
Total Operation and Maintenance	85,767.00	(12,029.80)	73,737.20
Depreciation	515.00	l	515.00
Amortization		417.00 m	417.00
Taxes Other Than Income Taxes	1,153.00		1,153.00
Total Operating Expenses	87,435.00	(11,612.80)	75,822.20
Net Operating Income	(24,368.00)	20,480.80	(3,887.20)
Less: Interest Expense	0.00	n	0.00
Net Income	\$ (24,368.00)	\$ 20,480.80	\$ (3,887.20)

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STAFF'S RECOMMENDED OPERATIONS

(a) Operating Revenues. Orchard Grass's 1996 annual report indicated that Orchard Grass had 335 customers with annual revenues from rates of \$63,067.00. Orchard Grass's 1997 annual report showed Orchard Grass had 407 customers. Staff used the number of customers at the end of 1997 to calculate normalized operating revenues of \$71,935.00. The calculation is as follows:

Residential customers	405.00
Times: Current rate	\$12.71
Annualize	<u>12.00</u>
Normalized residential revenue	<u>\$61,770.60</u>
Rest areas	2.00
Times: Current rate	\$423.50
Annualize	<u>12.00</u>
Normalized rest area revenue	<u>\$10,164.00</u>
Total normalized revenue	<u><u>\$71,935.00</u></u>

The two rest areas located on interstate 71 are charged a monthly flat rate of \$423.50 each. To calculate the rate Orchard Grass estimated the daily flow from each rest area to be 10,000 gallons per day and applied a residential equivalency factor of 300 gallons per day. The calculation is as follows:

Daily flow	10,000.00
Divide by: 300 gallons	<u>300.00</u>
Residential equivalents	33.33
Times: Current residential monthly rate	<u>\$ 12.71</u>
Monthly Charge (rounded to nearest \$.50)	<u><u>\$ 423.50</u></u>

The equivalency factor included in Orchard Grass's tariff is 400 gallons per day. Orchard Grass stated that a 300 gallon per day factor was more appropriate in this

ATTACHMENT B
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STAFF'S RECOMMENDED OPERATIONS

instance given the strength of the effluent discharged by the rest areas. Staff agrees and has used the 300 gallon factor to calculate the rates recommended in this case. Orchard Grass should include this factor in its revised tariff after rates have been approved by the Commission.

(b) Owner/Manager Fee. Orchard Grass reported \$10,000.00 for owner/manager fees during 1996. The Commission limits this fee to \$3,600.00 for small investor owned utilities such as Orchard Grass. Therefore, Staff decreased test year operations by \$6,400.00.

(c) Other - Labor. During the test year Orchard Grass expensed payments to Beckmar Lab that totaled \$2,745.00. \$585.00 was for a sludge analysis while the remainder of \$2,160.00 was for monthly testing fees. Orchard Grass proposed to increase the test year expense by \$6,615.00 to recover the cost of weekly testing that is now required by its Kentucky Pollutant Discharge Elimination System ("KPDES") permit. Orchard Grass calculated its adjustment based on a weekly testing fee of \$180.00.

Staff determined that weekly testing was required after review of Orchard Grass's KPDES permit. A review of current Beckmar Lab invoices revealed that the cost of a weekly test is \$160.00. Staff calculated the weekly testing adjustment to be \$6,160.00 $((\$160.00 \times 52) - \$2,160.00)$.

Staff eliminated the \$585.00 sludge analysis fee from this account and included a provision for its recovery over a five year period in the amortization expense account. The net adjustment to the other - labor account is \$5,575.00.

(d) Routine Maintenance Fee. Orchard Grass proposed to increase test year expense of \$7,800.00 by \$4,380.00 to recover an increase in the maintenance fee. The

ATTACHMENT B
STAFF REPORT CASE NO. 97-458
STAFF'S RECOMMENDED OPERATIONS

utility attributed the higher fee to the number of daily visits to the plant doubling under the new contract, the increased work required to operate the new dechlorination unit, and inflation. Four sewer utilities owned by Carroll Cogan filed applications for rate increases on the same date. Three of these companies, including Orchard Grass, have routine maintenance performed by Andriot-Davidson Company ("A-D"). Martin Cogan, Carroll Cogan's son, and Larry Smither own A-D. During the test year, two companies had monthly fees of \$625.00 and one was \$650.00. The monthly fees proposed in the applications are \$725.00, \$863.00, and \$1,015.00. Despite repeated requests for documentation justifying the wide variance in proposed fees, no information to explain how fees were established was provided. The Commission's Division of Engineering advised that a monthly maintenance fee of \$625.00 appears reasonable. Due to the lack of information justifying the reasonableness of the proposed fees, Staff recommends that the monthly maintenance fees be limited to \$625.00.

(e) Outside Services Employed – Bookkeeping. During the test year Orchard Grass reported outside services employed for bookkeeping of \$2,850.00. That amount consisted of \$1,050.00 paid to Linda Wood and \$1,800.00 accrued payable to Carroll Cogan, owner of Orchard Grass. Orchard Grass proposed to increase this expense by \$1,200.00 for additional amounts to be paid to Mr. Cogan.

During the review Staff determined that Ms. Wood provides bookkeeping services for all six of Mr. Cogan's sewer utilities for \$185.00 per week or \$9,620.00 annually. Staff has allocated 1/6 or \$1,603.00 of Ms. Wood's annual fee to Orchard Grass for determining revenue requirements in this case.

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STAFF REPORT CASE NO. 97-458
STAFF'S RECOMMENDED OPERATIONS

Staff has eliminated the \$1,800.00 accrued payable to Mr. Cogan and recommends that the requested increase of \$1,200.00 be denied. Staff determined that the only functions Mr. Cogan performed relative to bookkeeping duties for Orchard Grass was to sign some checks and approve payment of invoices for items that were either over a predetermined amount or considered out of the ordinary course of business. Staff is of the opinion that the owner/manager fee of \$3,600.00 provides for reasonable compensation for the performance of these duties.

(f) Outside Services Employed - Accounting. Logsdon and Co. provides accounting services to Orchard Grass that includes the preparation of the Commission's annual report and state and federal tax returns. The fee for 1998 is \$1,200.00. Staff has decreased the reported test year expense of \$1,764.00 by \$564.00.

(g) Outside Services Employed - Legal. Orchard Grass reported test year legal fees of \$2,075.00 that included payments to Greenebaum, Doll & McDonald and Kruger, Schwartz & Morreau for \$1,800.00 and \$275.00, respectively. As a part of Staff's review, independent supporting documentation was specifically requested for these items.

To support the Greenebaum, Doll & McDonald payment, Orchard Grass submitted a copy of an invoice billed to them by Carroll Cogan Companies for \$1,800.00. The invoice stated that the amount was for "pro-rata legal fees for counseling and legal advice relative to...sewer service to I-71 north and south rest areas". The invoice was not a source of independent documentation as Mr. Cogan owns both Orchard Grass and Carroll Cogan Companies. Additionally, the invoice did not present enough information so that the pro-ration could be analyzed. In the absence

ATTACHMENT B
STAFF REPORT CASE NO. 97-458
STAFF'S RECOMMENDED OPERATIONS

of such documentation, Staff was unable to verify the nature of the expense or determine its reasonableness. Therefore, Staff eliminated this expense from test year operations.

Orchard Grass provided an invoice from Kruger, Schwartz & Morreau in the amount of \$275.00. The explanation for the charge read "various conferences and meetings with Carroll Cogan; review of correspondence and various agreements; general corporate advice". This explanation is vague and does not offer enough information for Staff to determine whether the services were incurred as a result of prudent business practices. Staff eliminated this expense from test year operations.

(h) Outside Services Employed - Other Consulting Fees. Orchard Grass paid Larry Smither \$1,200.00 during the test year to perform weekly inspections and prepare a report summarizing those inspections. Mr. Smither is 50 percent owner of A-D that currently contracts with Orchard Grass to perform inspections. Staff eliminated the inspection fees of \$1,200.00 as Mr. Smither is already responsible and compensated for inspecting Orchard Grass's treatment facility as an owner of A-D.

The test year also included \$1,800.00 for a monthly fee of \$150.00 payable to Martin and Assoc. for serving as a liaison between the utility and the Division of Water ("DOW") and for submission of the monthly discharge monitoring reports. Martin Cogan, son of Carroll Cogan, owns Martin and Assoc. It was reported to Staff that Martin and Assoc. does not provide this service to any sewer companies not owned by Carroll Cogan. Dealing with DOW and signing the discharge monitoring reports are part of the management function and are compensated by the management fee. Staff does not consider this a prudent, necessary expense and removed it from test year operations.

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STAFF'S RECOMMENDED OPERATIONS

The net decrease to test year operations for other consulting fees is \$3,000.00.

(i) Insurance Expense. Test year expenses included \$1,856.00 for insurance expense. According to invoices and policies provided by the utility, the cost of a commercial package for all companies owned by Mr. Cogan was \$5,885.00. The policy covered 8 entities. Staff allocated the cost of the insurance equally to all entities. This results in an insurance expense of \$736 and a decrease to test year operations of \$1,120.00.

(j) Transportation. Orchard Grass accrued \$1,912.00 payable to Mr. Cogan in the transportation expense account. This amount represented a portion of Mr. Cogan's personal automobile lease. No evidence was presented as to the reasonableness of this accrual or its calculation. Staff could not determine what amount should be allowed for Mr. Cogan's transportation expense as a mileage log was not maintained. Staff eliminated \$1,912.00 from test year operations.

(k) Miscellaneous. Included in test year miscellaneous expense were checks paid to American Express and Carroll Cogan for \$660.80 and \$326.00, respectively. Neither check was supported by independent documentation and was therefore eliminated from test year operations. The total adjustment was \$986.80.

(l) Depreciation. Orchard Grass proposed to increase test year depreciation expense by \$2,009.00 to include the five year depreciation of a Purestream comminutor that cost 10,045.00. The comminutor was initially purchased by A-D from Renfro and Assoc. and then was sold to Orchard Grass from A-D for \$10,045.00. Staff was not provided with an invoice for the initial purchase from Renfro and Assoc. making the

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STAFF REPORT CASE NO. 97-458
STAFF'S RECOMMENDED OPERATIONS

original cost undeterminable. Staff recommends that the requested adjustment be denied.

(m) Amortization. Orchard Grass proposed to amortize rate case expense of \$1,500.00 over 3 years. Staff is of the opinion that rate case expenses should be amortized over the reasonably anticipated life of the rates, which generally will not exceed five years. In light of the fact that Orchard Grass's current rates were approved eight years ago, Staff recommends that rate case expenses in this case be amortized over five years.

Staff has amortized the previously mentioned sludge analysis fee of \$585.00 over a five year period. This fee is not an annual expense and its frequency of recurrence is unknown. Therefore, Staff amortized it over the life of the rates to be established in this case.

The net increase for the amortization adjustments is \$417.00 $((\$1,500.00 + \$585.00) / 5)$.

(n) Interest Expense. Orchard Grass proposed to include interest on a three year \$40,000 loan of \$1,932.00. From information provided by Orchard Grass, Staff determined that the majority of the items financed by the loan were operating expenses. This Commission does not allow the recovery of interest expense incurred on loan funds used to pay operating expenses. The remaining funds were used to purchase the comminutor, referred to in item (l), and two blowers.

Staff disallowed the interest on the comminutor due to lack of supporting documentation of the original cost. The blowers were purchased at a combined cost of \$7,522.00 from Tipton Environmental and were used to replace two existing blowers.

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STAFF'S RECOMMENDED OPERATIONS

Orchard Grass has six separate blower units. During review Staff found that Orchard Grass paid \$5,176.53 to A-D for blower repairs. Staff was unable to identify the blower unit for which each repair was performed. Before Staff can include any portion of the new blower's cost in pro forma operations, the test year repair costs for the replaced blowers would have to be identified and eliminated from test year operations or pro forma expenses would not be indicative of normal operations. Staff recommends that Orchard Grass's adjustment be disallowed.

ATTACHMENT C
STAFF REPORT CASE NO. 97-458
COMPARISON OF REQUESTED AND RECOMMENDED
REVENUE REQUIREMENTS

	Requested by Orchard Grass	Recommended by Staff
Operating Expenses	\$ 102,139.00	\$ 75,822.20
Divide by: Operating Ratio	0.88	0.88
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Required Revenue from Operating Ratio	116,067.05	86,161.59
Plus: Interest Expense	1,932.00	0.00
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Required Revenue	117,999.05	86,161.59
Less: Normalized Revenue	(63,067.00)	(71,935.00)
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Required Increase	\$ 54,932.05	\$ 14,226.59
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ATTACHMENT D
STAFF REPORT 97-458
RECOMMENDED SEWER RATES

RECOMMENDED RATES

Single Family Residential

\$15.25 per Month

Residential equivalency factor to be used for rest areas is 300 gallons per day or
9,000 gallons per month