

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF 4-WAY)
ENTERPRISES, INC., COOLBROOK)
SANITATION DIVISION FOR A RATE) CASE NO. 98-284
ADJUSTMENT PURSUANT TO THE)
ALTERNATIVE RATE FILING FOR)
SMALL UTILITIES)

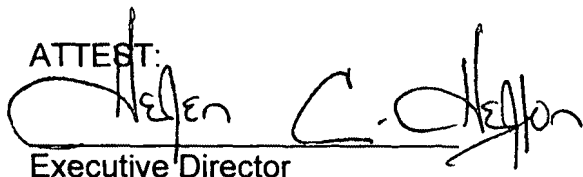
O R D E R

On May 27, 1998, 4-Way Enterprises, Inc. ("4-Way") filed its application for Commission approval of proposed sewer rates. Commission Staff, having performed a limited financial review of 4-Way'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 25th day of August, 1998.

ATTEST:


Executive Director

PUBLIC SERVICE COMMISSION


For the Commission

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STAFF REPORT

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

STAFF REPORT

ON

4-WAY ENTERPRISES, INC.

CASE NO. 98-284

On May 27, 1998, 4-Way Enterprises, Inc. ("4-Way") filed its application seeking to increase its rates pursuant to 807 KAR 5:076. The application was amended on July 21, 1998. In order to evaluate the requested increase, Commission Staff ("Staff") performed a limited financial review of 4-Way's test period operations, the year ending December 31, 1997.

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.

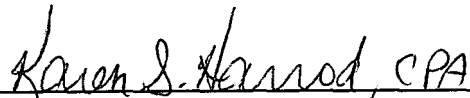
Karen Harrod of the Commission's Water and Sewer Revenue Requirements Branch began the limited review on June 10, 1998 and is responsible for the preparation of this Staff Report.

A comparison of 4-Way's actual and proposed pro-forma operations is shown in Attachment A. Based on Staff's recommendations, 4-Way's operating statement would appear as set forth in Attachment B.

Attachment C compares 4-Way's and Staff's revenue requirement calculations. 4-Way determined its pro forma revenue requirement to be \$154,930, an increase over test year revenues of \$63,835. Staff recommends a revenue requirement of \$109,318 or

a \$15,002 increase. The rates contained in Attachment D will achieve Staff's recommended level of revenue.

Signatures


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

ATTACHMENT A
 STAFF REPORT CASE NO. 98-284
 4-WAY ENTERPRISES, INC. - REQUESTED OPERATIONS

	Test Year per Annual Report	Requested Adjustments	Requested Operations
Operating Revenues	91,095		91,095
Operating Expenses:			
Supervision	4,800		4,800
Labor & Exp.			
Collection System Expense	1,369		1,369
Pumping System Expense	1,574		1,574
Sludge Hauling	15,450		15,450
Utility Service - Water Cost	544		544
Other Labor, Materials, & Expenses	25,305	6,185	31,490
Fuel & Power Purchased	10,503		10,503
Chemicals	1,734	2,458	4,192
Routine Maintenance	6,950	4,450	11,400
Maintenance	3,893		3,893
Collection Expense	13,664	9,477	23,141
Office Expense	111		111
Outside Services	1,312		1,312
Insurance Expense	2,474		2,474
Miscellaneous Expense	85		85
Depreciation Expense	16,766	4,303	21,069
Amortization Expense	-	1,510	1,510
Taxes Other than Income Taxes	1,511	-	1,511
Total Operating Expenses	<u>108,045</u>	<u>28,383</u>	<u>136,428</u>
Operating Income	(16,950)	(28,383)	(45,333)
Interest Expense	<u>10,872</u>	<u>(10,872)</u>	<u>-</u>
NET INCOME	<u>(27,822)</u>	<u>(17,511)</u>	<u>(45,333)</u>

ATTACHMENT B
STAFF REPORT CASE NO. 98-284
STAFF'S RECOMMENDED OPERATIONS

	Test Year per Annual Report	Recommended Adjustments	Ref	Recommended Test Year
Operating Revenues	91,095	3,221	a	94,316
Operating Expenses:				
Supervision	4,800	(1,200)	b	3,600
Labor & Exp.				
Collection System Expense	1,369			1,369
Pumping System Expense	1,574			1,574
Sludge Hauling	15,450			15,450
Utility Service - Water Cost	544			544
Other Labor, Materials, & Expenses	25,305	(11,932)	c	13,373
Fuel & Power Purchased	10,503			10,503
Chemicals	1,734	2,458	d	4,192
Routine Maintenance	6,950	4,450	e	11,400
Maintenance	3,893			3,893
Collection Expense	13,664	-	f	13,664
Office Expense	111			111
Outside Services	1,312			1,312
Insurance Expense	2,474			2,474
Miscellaneous Expense	85	(60.00)	g	25
Depreciation Expense	16,766	(5,970)		10,796
Amortization Expense	-	1,333		1,333
Taxes Other than Income Taxes	1,511	-		1,511
Total Operating Expenses	<u>108,045</u>	<u>(9,721)</u>		<u>93,524</u>
Operating Income	(16,950)	12,942		792
Interest Expense	<u>10,872</u>	<u>(10,872)</u>		<u>-</u>
NET INCOME	<u>(27,822)</u>	<u>23,814</u>		<u>792</u>

ATTACHMENT B
STAFF REPORT CASE NO. 98-284
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(a) Operating Revenues. 4-Way reported operating revenues of \$91,095 for the test year. Based on the current monthly rate of \$18.45 and the current number of customers of 426, Staff has calculated normal operating revenues to be \$94,316. This resulted in an increase to test year revenues of \$3,221.

(b) Owner/Manager Fee. For the test year 4-Way reported \$4,800 in owner/manager fees. The Commission limits this fee to \$3,600 for small investor owned utilities such as 4-Way. Therefore, Staff decreased test year operations by \$1,200.

(c) Other – Labor, Materials & Expense. During the test year 4-Way incurred other labor, materials and expense costs of \$25,305. Included in this account were expenses for testing in the amount of \$1,095. 4-Way proposed to increase testing expense by \$6,185, to a level of \$7,280, based on the cost of new weekly testing at \$140 per week, or \$1,820 per quarter. However, according to the November 1997 cost estimate from Kenvirons, the cost of testing has increased to only \$1,750 per quarter, or \$7,000 annually. The difference in calculations resulted from Kenvirons combining some of the weekly testing with the monthly testing requirements. Accordingly, Staff made an adjustment to increase test year expense by \$5,905.

Also included in this account were expenses totaling \$22,296, incurred to clean up the creek after problems were encountered with the growth of young sludge. According to Mr. Sturgeon, the owner of 4-Way, this has never happened before and, though not guaranteed, is not likely to occur again. Staff has included an adjustment to amortize this expense over a period of 5 years, resulting in a decrease to test year expense of \$17,837.

ATTACHMENT B
STAFF REPORT CASE NO. 98-284
STAFF'S RECOMMENDED OPERATIONS

Based on the aforementioned adjustments, Staff has decreased other labor, materials and expense by \$11,932, to a level of \$13,373.

(d) Chemicals. 4-Way reported chemicals expense of \$1,734 for the test period which it proposed to increase by \$2,458. The proposed increase is based on monthly expenses of \$349.32 for the cost of chlorine and sulfur dioxide used in 4-Way's chlorinator/dechlorinator system. Staff has reviewed invoices to support this expense and concurs with the proposed adjustment. Accordingly, an adjustment has been included to increase test year chemicals expense to \$4,192.

(e) Routine Maintenance. During the test year 4-Way incurred routine maintenance expenses of \$6,950. In its application an adjustment was proposed to increase this expense by \$4,450 based on the monthly cost of routine maintenance of \$550 and the monthly cost of an operator of \$400. Staff has reviewed the contracts for these services and is of the opinion that these fees are reasonable for the services provided. Therefore, Staff has included the proposed adjustment for rate-making purposes.

(f) Billing & Collection. 4-Way is currently under contract with Farmdale Water District ("Farmdale") for the billing and collection of sewer bills. Farmdale charges 4-Way 15 percent of the total revenues collected in exchange for these services.

For the test year 4-Way incurred billing and collection expenses of \$13,664, or \$2.67 per bill. An adjustment was proposed to increase this amount by \$9,477, to a level of \$23,141, or \$4.53 per bill, as a result of the proposed increase in revenues. Based on an analysis of collection expense for other sewer utilities, which averaged \$2.00 per bill, Staff is of the opinion that \$4.53 is too high for the processing of one bill.

ATTACHMENT B
STAFF REPORT CASE NO. 98-284
STAFF'S RECOMMENDED OPERATIONS

In Case No. 91-394, Commission Staff recommended that 4-Way consider available alternatives to its present billing and collection agreement. Staff further recommended that the Commission require 4-Way, when filing its next rate application, to demonstrate that its billing and collection agreement with Farmdale is prudent and reasonable in light of other alternative methods available to 4-Way. These recommendations were adopted in the Commission's Final Order dated February 18, 1992.

In this proceeding no evidence has been presented to indicate that an attempt was made to consider other alternatives and nothing has been filed to demonstrate that the present billing and collection agreement with Farmdale is prudent and reasonable. In addition, there is no evidence to indicate that the cost of billing would increase as a direct result of increased revenues, assuming no additional customers are added.

Therefore, it is Staff's recommendation that billing and collection expense should not be increased but should be limited to the test year level of \$13,664.

(g) Depreciation. For the test year 4-Way reported depreciation expense of \$16,766 which it proposed to increase by \$4,303. The proposed increase is based on depreciation of the following items that were purchased subsequent to the test year:

Date Purchased	Description	Original Cost	Estimated Serv. Life	Annual Depr. Exp.
1/14/98	Chlorination System	\$5,366	5 years	\$ 1,073
5/1/98	Splitter Box	\$5,460	5 years	1,092
5/1/98	Control Panel	\$2,038	5 years	408
5/1/98	Scraping, Cleaning & Painting Tank	\$8,650	5 years	1,730
	TOTAL			\$ 4,303

ATTACHMENT B
STAFF REPORT CASE NO. 98-284
STAFF'S RECOMMENDED OPERATIONS

Commission Staff has reviewed the depreciable lives for these items and concurs with 4-Way's proposal of 5 years. Accordingly, Staff has included the increase to depreciation expense of \$4,303.

In addition, Staff has made an adjustment to decrease test year depreciation expense by \$10,273 to exclude depreciation on contributed property, pursuant to the Commission's policy to disallow depreciation on property funded by contributions in aid of construction for privately owned utilities.

As a result of these adjustments Staff has included a net decrease to depreciation expense of \$5,970.

(h) Amortization Expense. In its application 4-Way proposed to include the 3-year amortization of rate case expenses incurred as a result of this proceeding. Total rate case expense was originally estimated to be \$2,500. However, in the motion to amend its application, filed July 21, 1998, this amount was increased to \$4,500 to include anticipated legal fees. Staff has reviewed actual invoices for rate case expense in the amount of \$2,546 for accounting fees and office expenses. Accordingly, an adjustment has been made to include amortization expense of \$849. As other invoices for rate case expense are received by 4-Way and filed with the Commission, the appropriate adjustments will be made to the calculation of 4-Way's recommended revenue requirement and rate.

(i) Miscellaneous Expense. For the test year 4-Way reported Miscellaneous expense of \$85. Included in this account was \$60 for a food tray for the Farmdale

ATTACHMENT B
STAFF REPORT CASE NO. 98-284
STAFF'S RECOMMENDED OPERATIONS

Water District Office. It is the opinion of Staff that this is not an operating expense of the utility and should not be allowed for rate-making purposes.

(j) Interest Expense. 4-Way reported interest expense for the test period of \$10,872. An adjustment was proposed to exclude this expense for rate-making purposes because the related debt was to an associated company and should not be recovered through rates. Staff agrees that it is not appropriate to include this interest expense in the determination of 4-Way's revenue requirement.

It should also be noted that in Case No. 91-394, Staff advised 4-Way that, in the future, if 4-Way finds itself in a financial position where reasonable, legitimate expenses cannot be met, the Company should petition this Commission for an increase in rates. Staff reaffirms this recommendation and reminds 4-Way that when additional revenues are required to meet the operating expenses of the utility, it is management's responsibility to petition for a rate increase rather than to finance the additional expenses through personal loans.

ATTACHMENT C
 STAFF REPORT CASE NO. 98-284
 COMPARISON OF REQUESTED AND RECOMMENDED
 REVENUE REQUIREMENTS

	Requested by 4-Way	Recommended by Staff
Adjusted Operating Expenses	135,751	93,524
Operating Ratio	0.88	0.88
Required Operating Revenue before Income Taxes		106,277
Less: Adjusted Operating Expenses		93,524
Revenue Subject to Income Taxes		12,753
Gross-Up Factor		1.23839
Net Operating Income Inclusive of Provision for Income Taxes		15,794
Add: Adjusted Operating Expenses		93,524
Revenue Requirement	154,263	109,318
Add: Increase per Amended Application	667	-
Amended Revenue Requirement	154,930	109,318
Less: Normalized Test-Year Revenue	91,095	94,316
Required Increase	63,835	15,002

ATTACHMENT D
STAFF REPORT CASE NO. 98-284
RECOMMENDED SEWER RATES

RECOMMENDED RATES

Single Family Residential	\$ 21.38 per Month
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