

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF MOCKINGBIRD VALLEY)
SANITATION, INC. FOR AN ADJUSTMENT OF) CASE NO. 98-560
RATES PURSUANT TO THE ALTERNATIVE RATE)
PROCEDURE FOR SMALL UTILITIES)

ORDER

Mockingbird Valley Sanitation, Inc. (Mockingbird Valley) having applied for a rate adjustment, and Commission Staff having performed a limited review of Mockingbird Valley's operations and having prepared a report of its findings and recommendations,

IT IS THEREFORE ORDERED that:

1. The report of Commission Staff, appended hereto, is made a part of the record of this proceeding.
2. Within 14 days of the date of this Order, all parties shall carefully review the report and submit to the Commission their written comments on the report. In these comments, each party shall specifically identify those findings and/or recommendations to which it objects.
3. Within 14 days of the date of this Order, any party wishing an informal conference in this matter to discuss the report shall submit to the Commission a written request for such conference. In its request, the requesting party shall identify all issues that it wishes to address at the requested conference.

4. Within 14 days of the date of this Order, any party wishing a hearing in this matter shall submit to the Commission a written request for such hearing. In its request, the requesting party shall identify all issues that it wishes to present at hearing.

5. Unless a party submits written objections to the Commission Staff report within 14 days of the date of this Order, it shall be considered as agreeing with the report's findings and recommendations and waiving its right to object to those findings and recommendations.

6. If no objections to the Commission Staff report or requests for informal conference or hearing are received within 14 days of the date of this Order, this matter shall stand submitted to the Commission for decision.

Done at Frankfort, Kentucky, this 29th of July, 1999.

By the Commission

ATTEST:

Executive Director

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF MOCKINGBIRD VALLEY)
SANITATION, INC. FOR AN ADJUSTMENT OF)
RATES PURSUANT TO THE ALTERNATIVE RATE) CASE NO. 98-560
PROCEDURE FOR SMALL UTILITIES)

STAFF REPORT

Prepared By: John D. Williams
Public Utility Financial
Analyst, Senior
Water and Sewer Revenue
Requirements Branch
Division of Financial Analysis

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

STAFF REPORT
ON
MOCKINGBIRD VALLEY SANITATION, INC.
CASE NO. 98-560

A. Preface

On November 5, 1998, Mockingbird Valley Sanitation, Inc. (Mockingbird), applied for an adjustment of its rates for sewage treatment service pursuant to 807 KAR 5:076. Due to deficiencies, its application was not accepted for filing until December 9, 1998. Mockingbird requested a 41.8 percent increase in its sewage treatment service rates, which will generate additional revenues of \$8,435.

Mockingbird requested assistance from Commission Staff (Staff) in the preparation of its Alternative Rate Filing (ARF) application as allowed pursuant to 807 KAR 5:076, Section 2. To assist in the preparation of this application, Staff performed a limited financial review of Mockingbird s operations for the 1997 calendar year.

John Williams of the Commission s Water and Sewer Revenue Requirements Branch performed the limited review on May 21, 1998. Mr. Williams is responsible for the preparation of this Staff Report, except for the determination of normalized operating revenue and Attachment D, which was prepared by Renee Curry of the Commission s Communications, Water and Sewer Rate Design Branch.

A comparison of Mockingbird s actual and requested operations is shown in Attachment A. Based on Staff s recommendations, Mockingbird s operating statement would appear as set forth in Attachment B. Attachment C shows Staff s recommended

revenue requirement calculation. Staff's recommendation provides for a revenue requirement of \$25,033 or an increase in revenues of \$4,864.

Staff's recommended rate in Attachment D will generate the required revenue from rates of \$25,033.

Scope

The scope of the 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.

B. Analysis of Operating Revenues and Expenses

Operating Revenues

Mockingbird reported operating revenue of \$18,241 in its 1997 annual report to the Commission. Based on the end-of-period customer level, including free service to the utility's owner and son, granted by the Commission in Mockingbird's last rate case,¹ and the utility's current rate, the normalized revenue from rates would be \$20,169 (45 customers x \$37.35 x 12 months). Therefore, Staff recommends that operating revenue be increased by \$1,928.

Operating Expenses

In its application, Mockingbird reported actual and requested test period operating expenses of \$16,959 and \$24,507, respectively. The following are Staff's

¹ Case No. 94-034, The Application of Mockingbird Valley Sanitation, Inc. for a Rate Adjustment Pursuant to the Alternative Rate Filing Procedure for Small Utilities, Final Order Dated August 5, 1994.

recommended adjustments to Mockingbird's actual test period operations and discussion of Mockingbird's proposed adjustments:

Owner/Manager Fee:

In its application, Mockingbird requested \$3,600 for owner/manager fees, an increase of \$2,300 from the amount Mockingbird reported in the test period to the Commission in its annual report of \$1,300. Included in that amount were payments to owner/manager Myra Schureck of \$1,000 and the utility's CPA fee of \$300 misposted to this account. The Commission has allowed sewer utilities of Mockingbird's size \$3,600 annually, which is reasonable in this instance. Staff recommends that test period operations be increased by \$2,300 to reflect an annual owner/manager fee of \$3,600.

Sludge Hauling:

During the test period Mockingbird paid one sludge hauling fee in the amount of \$396, but misposted this amount as routine maintenance fee on its 1997 annual report to the Commission. Based on the utility plant operator's recommendation, the age of the plant requires that the sludge hauling be increased to six 5,000-gallon loads annually. The Commission's engineering division cited the utility for needing the digester cleaned of sludge in the 1998 inspection. However, considering that there was only one load of sludge hauled in 1997, Staff has used the average of the loads hauled in years since the last rate case, combined with the operator's recommended number of loads to arrive at a pro forma level of expense. The five-year average calculated is 3 loads annually. Based on the most recent cost quotes for sludge hauling, the pro forma sludge hauling expense would be \$1,248 ($\416.15×3 loads). Therefore, Staff

recommends that test period operations be increased by \$1,248 to reflect annual sludge hauling fees of \$1,248.

Routine Maintenance Fee:

Mockingbird requested a routine maintenance fee of \$3,630, a decrease of (\$3,313) from the total reported in its 1997 annual report to the Commission of \$6,943. The basis for this annual expense is a 10 percent increase in the monthly service fee charged by the utility's contract plant operator, from \$275 monthly, to \$302.50 monthly (\$302.50 x 12 = \$3,630). The operator has not increased the monthly service fee since 1994. Commission Staff finds that based upon its knowledge of comparable sewer utilities, the requested monthly fee of \$302.50 is within a reasonable range and therefore, it should be reflected in recommended operations.

During Staff's field review, items were noted that should have been separately stated as different operating expenses, rather than grouped together with routine maintenance fees, account 710-A according to the Uniform System of Accounts (USOA). These operating expenses are as follows:

Effluent testing fees	\$1,755
Mowing fees	650
Repairs to maintain treatment and disposal plant	842
Sludge hauling	<u>396</u>
Pro Forma Adjustments to Reclassify from Routine Maintenance Fees	\$3,643

Considering the above mentioned increase in monthly service fees and the pro forma reclassifications, Staff recommends that routine maintenance fees be reduced by (\$3,313) to an adjusted balance of \$3,630 annually.

Maintenance of Treatment & Disposal Plant:

General repairs to treatment and disposal plant misclassified in the 1997 annual report to the Commission as routine maintenance fees totaling \$842 have been reclassified to properly show the expenditures in account 714 of the USOA. Therefore, Staff recommends test period operations be increased by \$842 to reflect this amount as maintenance of treatment and disposal plant.

Maintenance Other Mowing Fees:

Other maintenance for mowing fees misclassified in the 1997 annual report to the Commission as routine maintenance fees totaling \$650 have been reclassified to properly show the expenditures in account 715 of the USOA. Therefore, Staff recommends test period operations be increased by \$650 to reflect this amount as maintenance other mowing fees.

Billing and Collection Fees:

Mockingbird s customer billing and collection is performed by the Oldham County Water District at a fee of \$2 per customer bill. This fee combined with the number of test period customers results in Mockingbird s recommended billing and collection fee expense of \$1,032.

Mockingbird s test period operating revenues were reported on the annual report to the Commission net of billing and collection expense. Since the operating revenues recommended herein reflect the gross billings, Staff recommends that test period operations be increased by billing and collection expenses in the amount of \$1,032.

Outside Services Accounting:

As explained in the section on owner/manager fee , Mockingbird s annual fee for preparing its income tax returns and annual report to the Commission was included in the wrong account on the 1997 annual report to the Commission. Additionally, Staff believes the utility is entitled to a reasonable fee for outside services for the preparation of an annual general ledger and financial statement, from which tax returns and the annual report to the Commission may be generated. Staff considers \$350 a reasonable amount for general ledger and financial statement preparation, based upon its knowledge of other comparable sewer utilities. Staff considers \$300 a reasonable amount for tax return and annual report preparation, based upon its knowledge of other comparable sewer utilities. Therefore, Staff recommends increased test period operations of \$650 for reclassifying and adjusting the amount of expense for outside services accounting, which results in a pro forma adjustment and annual expense of \$650.

Outside Services Kentucky Pollutant Discharge Elimination System (KPDES) Testing:

Mockingbird requested outside services KPDES testing fees totaling \$1,620 annually, or \$135 per month. Mockingbird paid \$1,755 as noted in the section on routine maintenance fee, for 13 months testing in 1997, but only 12 months expenditures are permitted in Staff recommended operations. The operating permit with the State requires monthly effluent tests by Mockingbird.

Therefore, Staff recommends increased test period operations for outside services KPDES testing in the amount of \$1,620.

Depreciation:

Mockingbird requested depreciation expense of \$4,969, a \$353 increase over the amount reported on the 1997 annual report to the Commission. Mockingbird included adjustments for depreciable assets recommended as necessary by its plant operator. Based on Staff's experience with treatment plants of Mockingbird's age, Staff accepts these proposed replacements and betterments to the plant.

Based upon Mockingbird's past filings with the Commission, Staff recommends denial of the allowance for depreciation expense on initial utility plant expenditures. The Commission in Case No. 7001² stated [t]hat the Applicant [Mockingbird] will finance the project cost of approximately \$164,675 through a development loan and plans to recover all associated construction and installation costs of the sewer collection system through the sale of residential lots within the subdivision.

In its final Order in Case No. 7001,³ the Commission held that it is common for a builder or developer to construct water and sewage facilities that add to the value and salability of his subdivision lots and to expense this investment cost in the sale price of these lots or, as an alternative to donate these facilities to a utility company. The Commission determined that to permit the accumulation of a depreciation reserve on

² Case No. 7001, The Application of Mockingbird Valley Sanitation, Inc., a Kentucky Corporation, for an Order Pursuant to Chapter 278 of the Kentucky Revised Statutes for a Certificate of Public Convenience and Necessity Authorizing and Permitting Said Applicant to Construct a Waste Water Collection and Treatment System to Serve the Residents of Mockingbird Valley Subdivision in Oldham County, Kentucky, (April 19, 1978) at 2.

³ Case No. 7001, Order dated June 5, 1978 at 3.

contributed property that is to be abandoned would not, in our opinion, be in the public interest.

As an alternative to depreciation for rate-making purposes, the Commission found that the utility should establish a reserve fund to replace contributed short-lived plant and equipment. Short-lived plant and equipment was defined as assets having a useful life of ten years or less. The amount allowed for this reserve fund was \$3,055. Staff is of the opinion that this amount is reasonable and, based on the Commission's finding in Case No. 7001, proposes an increase in operating expenses for rate making purposes of \$3,055 to include funding for the depreciation special reserve fund.

Commission Staff recommends that depreciation expense be computed as follows:

Depreciation per 1997 annual report to the Commission	\$4,616
Less: Depreciation expense disallowed pursuant to Case No. 7001	(4,616)

Add:

Plant improvements needed:	Estimated Cost	Useful Life	Depr. Exp.
Diffusers (2)	\$ 400	3	\$133
Blower check valve	220	5	44
Time clock	180	5	36
Repair Paint metal on plant	\$1,400	10	<u>140</u>
Subtotal Pro Forma Adjustments			<u>353</u>
Pro Forma Depreciation Expense			\$ 353

In summary, Commission Staff recommends depreciation expense of \$353 and the establishment of a depreciation special reserve fund equal to \$3,055.

Amortization KPDES Permit:

Mockingbird requested amortization KPDES permit of \$300, a \$300 increase over that reported on the 1997 annual report to the Commission. The current permit cost of \$1,500, was paid for in 1996 and expires in 2001. Therefore, Staff determines the cost to benefit more than one period (including the test period and future periods) and recommends the increase to test period operations for the amortization of this cost over the period benefited ($\$1,500 / 5 \text{ years} = \$300 \text{ annual amortization}$). Accordingly, amortization KPDES permit is increased by \$300 for Staff recommended operations.

Amortization Sludge Testing for Metropolitan Sewer District (MSD):

Mockingbird requested amortization sludge testing for MSD of \$117, a \$117 increase over that reported on the 1997 annual report to the Commission. In 1996 Mockingbird was required to pay a \$585 nonrecurring charge to Beckmar Environmental Laboratory for special sludge testing so MSD would accept the utility's sludge for disposal. Although this was not an expense of the test period, Staff deems the cost amortizeable over the same period as the KPDES permit due to the increased amount of sludge testing placed on small utilities by MSD for sludge disposal. Therefore, Staff recommends a pro forma adjustment increasing test period operations for amortization sludge testing for MSD in the amount of \$117 ($\$585 / 5 = \$117 \text{ annual amortization}$).

Amortization Grading and Rock for Road:

Mockingbird requested amortization grading and rock for road of \$250, a \$250 increase over that reported on the 1997 annual report to the Commission. The utility plant operator recommended rock and grading for the road to the sewage treatment plant. The owner's estimated cost for this is \$1,000. The Commission's engineering

division agrees that the road needs improvement. Since this is not an annual expenditure, the cost is amortized over the period since the last rate case, four years (\$1,000 / 4 = \$250 annual amortization). For the above reasons, and the future period benefit of this expenditure, Staff recommends a pro forma adjustment increasing test period operations for amortization grading and rock for road in the amount of \$250.

Interest Expense:

Mockingbird borrowed \$184,490 from Bertrand Schureck (deceased), its former owner, to install the treatment plant, lift station, and fence. The indebtedness is now owed to Myra Schureck, owner/manager. Generally, the Commission allows a dollar-for-dollar coverage of interest in the revenue requirement calculation. Because of the significant impact the interest expense would have on its monthly rate, Mockingbird chose in the past not to ask for its recovery.

According to KRS 278.300 (1), [n]o utility shall issue any securities or evidences or indebtedness, or assume any obligation or liability in respect to the securities or evidences of indebtedness of any other person until it has been authorized so to do by order of the commission. However KRS 278.300 (8) states that this section is not applicable if the indebtedness has a two-year term, and is renewed in aggregate for a total of no more than six years from the date of the original issuance.

Because Mockingbird's loans were due and payable in one-year increments they would not have required prior Commission authorization. However, the six-year renewal period has been exceeded thus requiring Commission approval. To date Mockingbird has not requested or received Commission authorization to incur its indebtedness to Mrs. Schureck.

Given that the Commission did not authorize Mockingbird's loans, Staff deems that any associated interest expense should be excluded for rate making purposes. Therefore, Staff recommended operations reflect a reduction to interest expense of (\$5,850).

C. Revenue Requirements Determination

The 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 a basis for rate-of return determination does not exist or the utility plant investment has been depreciated or recovered through the receipt of contributions. Staff recommends the use of this approach in determining Mockingbird's revenue requirement. The calculation is set forth in Attachment C.

D. Rate Design

The rate design is based on a flat rate monthly charge, regardless of usage. All customers are residential users.

Signatures

Prepared By: John D. Williams
Public Utility Financial
Analyst, Senior
Water and Sewer Revenue
Requirements Branch
Division of Financial Analysis

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

ATTACHMENT A
 STAFF REPORT CASE NO. 98-560
 MOCKINGBIRD'S REQUESTED OPERATIONS
 TEST YEAR ENDING DECEMBER 31, 1997

	Actual Operations	Adjustments	Requested Operations
Operating Revenue:			
Flat Rate - General Customers	\$ 18,241	\$ 1,928	\$ 20,169
Total Operating Revenues	<u>\$ 18,241</u>	<u>\$ 1,928</u>	<u>\$ 20,169</u>
Operating Expenses:			
Owner/Manager Fee	1,300	2,300	3,600
Sludge Hauling	-	2,497	2,497
Purchased Power	2,784	-	2,784
Routine Maintenance Fees	6,943	(3,313)	3,630
Maintenance of Treatment & Disposal Plant	-	842	842
Maintenance - Other - Mowing Fees	-	650	650
Billing and Collection Fees	-	1,032	1,032
Office Supplies & Other Expenses	1,061	-	1,061
Bookkeeping	-	600	600
Outside Services - Accounting	-	300	300
Other Outside Services - KPDES Testing	-	1,620	1,620
Depreciation	4,616	353	4,969
Amortization - KPDES Permit	-	300	300
Amortization - Sludge Testing for MSD	-	117	117
Amortization - Grading and Rock for Road	-	250	250
Taxes Other Than Income	255	-	255
Total Operating Expenses	<u>\$ 16,959</u>	<u>\$ 7,548</u>	<u>\$ 24,507</u>
Other Income (Expense) - None	-	-	-
Net Income Available for Operations	<u>\$ 1,282</u>	<u>\$ (5,620)</u>	<u>\$ (4,338)</u>

ATTACHMENT B
 STAFF REPORT CASE NO. 98-560
 STAFF RECOMMENDED OPERATIONS
 TEST YEAR ENDING DECEMBER 31, 1997

	Actual Operations	Pro Forma Adjustments	Staff Recommended Operations
Operating Revenue:			
Flat Rate - General Customers	\$ 18,241	\$ 1,928	\$ 20,169
Total Operating Revenues	<u>\$ 18,241</u>	<u>\$ 1,928</u>	<u>\$ 20,169</u>
Operating Expenses:			
Owner/Manager Fee	1,300	2,300	3,600
Sludge Hauling	-	1,248	1,248
Purchased Power & Water	2,784	-	2,784
Routine Maintenance Fees	6,943	(3,313)	3,630
Maintenance of Treatment & Disposal Plant	-	842	842
Maintenance - Other - Mowing Fees	-	650	650
Billing and Collection Fees	-	1,032	1,032
Office Supplies & Other Expenses	1,061	-	1,061
Outside Services - Accounting	-	650	650
Other Outside Services - KPDES Testing	-	1,620	1,620
Depreciation	4,616	(4,263)	353
Depreciation Special "Reserve Fund"	-	3,055	3,055
Amortization - KPDES Permit	-	300	300
Amortization - Sludge Testing for MSD	-	117	117
Amortization - Grading and Rock for Road	-	250	250
Taxes Other Than Income	255	-	255
Total Operating Expenses	<u>\$ 16,959</u>	<u>\$ 4,488</u>	<u>\$ 21,447</u>
Other Expense:			
Interest Expense	5,850	(5,850)	-
Net Income Available for Operations	<u>\$ (4,568)</u>	<u>\$ 3,290</u>	<u>\$ (1,278)</u>

ATTACHMENT C
STAFF REPORT CASE NO. 98-560
STAFF RECOMMENDED REVENUE REQUIREMENT CALCULATION

	Amount
Pro Forma Operating Expenses	\$ 21,447
Divided by: Requested Operating Ratio	88%
Subtotal	24,372
Less: Pro Forma Operating Expenses	21,447
Margin After Income Taxes	2,925
Multiplied by: Income Tax Gross-up Factor	1.22549
Margin Before Income Taxes	3,586
Add: Pro Forma Operating Expenses	21,447
Interest Expense	-
Total Revenue Requirement	25,033
Less: Non-Operating Income	-
Revenue Requirement from Operations	25,033
Less: Forfeited Discounts	-
Revenue Requirement from Rates	25,033
Less: Normalized Operating Revenues from Rates	20,169
Requested Operating Revenue Increase	\$ 4,864
	Divided by number of months & customers
Increase to Flat Revenue Rate	\$ 4,864 12 45
Old Rate	\$ 37.35
Proposed New Rate	\$ 46.36
Total customers served	45
Times: Number of months	12
Proposed New Rate	\$ 46.36
Revenue Requirement from Rates	\$ 25,034

ATTACHMENT D
STAFF REPORT CASE NO. 98-560
MOCKINGBIRD VALLEY SANITATION, INC.
RECOMMENDED RATES

Monthly Rate

Flat Rate Residential Service

\$46.36

