

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF BIG BEAR WASTEWATER,)
INC. FOR A RATE ADJUSTMENT PURSUANT TO) CASE NO.
THE ALTERNATIVE RATE FILING PROCEDURE) 99-114
FOR SMALL UTILITIES)

ORDER

On April 19, 1999, Big Bear Wastewater, Inc. (Big Bear) filed its application for Commission approval of proposed sewer 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 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 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 3rd day of June, 1999.

ATTEST:

By the Commission

Executive Director

STAFF REPORT
ON
BIG BEAR WASTEWATER, INC.
CASE NO. 99-114

On September 14, 1998, the Public Service Commission (Commission) received a letter from Big Bear Wastewater, Inc. (Big Bear) requesting Commission assistance with the preparation of a rate application. Commission Staff (Staff) provided that assistance by performing a limited financial review of Big Bear's test year operations, the calendar year ending December 31, 1998. 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 operation. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

Upon completion of the review, Staff assisted Big Bear in the development and preparation of a rate application. The application included an adjusted pro forma operating income statement wherein adjustments were made to test year operating revenues and expenses that were known and measurable and deemed to be reasonable. The rates proposed in the application were based on the pro forma income statement. The pro forma income statement supports a revenue requirement of \$29,657. The rate proposed to meet that requirement is a flat monthly fee of \$35.99 per customer. The proposed rate is a 22 percent increase over the current monthly fee of \$29.50. The proposed rate was calculated by dividing the revenue requirement of \$29,657 by the total number of pro forma bills of 824. The number of bills was calculated using the test year end number of customers of 73. Of those customers 60

were year round customers and 13 were campsites that were billed for only 8 months of the year. Thus, the calculation appears as follows: $(60 \times 12) + (13 \times 8) = 824$.

On March 23, 1999 Big Bear submitted the rate application to the Commission for consideration. The application was considered filed on April 19, 1999, when all filing deficiencies were cured.

The pro forma income statement and explanation of adjustments have been attached to this report as Attachment A. Attachment B details the calculation of the revenue requirement and the recommended rate. Renee Curry is responsible for all revenue adjustments and the calculation of the recommended rate. Scott Lawless is responsible for the determination of the revenue requirement. Based on the information included in this report, Staff is of the opinion that the rate proposed by Big Bear in its application is reasonable and should be approved by this Commission.

Signatures

Prepared by: Jack Scott Lawless, CPA
Financial Analyst, Water and Sewer
Revenue Requirements Branch
Division of Financial Analysis

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

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BIG BEAR S REQUESTED AND STAFF S RECOMMENDED OPERATIONS

	Test Year	Adjustments	Ref.	Pro forma Present Rates
Sewer Service Revenues	22,629	1,679	A	24,308
Operating Expenses				
Operation and Maintenance				
Salaries and Wages	9,130	446	B	9,576
Sludge Hauling	2,060	(1,220)	C	840
Chemicals	318			318
Materials and Supplies	1,888	(1,138)	D	750
Contractual Services	5,509	(3,096)	E	2,413
Purchased Power	3,592			3,592
Insurance	100	1,589	F	1,689
Miscellaneous	477	466	G	943
Total Operation and Maintenance	23,074	(2,953)		20,121
Depreciation	-	3,965	H	3,965
Taxes Other Than Income	1,252	34	I	1,286
Total Operating Expenses	24,326	1,046		25,372
Net Operating Income	(1,697)	633		(1,064)

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A) Sewer Service Revenues. Big Bear reported test year operating revenues of \$22,629. Staff increased test year revenue to \$24,308 so that pro forma operations at present rates would reflect the number of customers hooked onto the system at the end of the test year. The amount was calculated as follows:

Revenue from full year customers (60 customers x 12 months x \$29.50 current rate)	\$21,240.00
Revenue from seasonal customers (13 customers x 8 months x \$29.50 current rate)	<u>3,068.00</u>
Total	<u>\$24,308.00</u>

B) Salaries and Wages. Test year salaries expense of \$9,130 was increased by \$446 to reflect the following current pay levels:

Dick Eastham (Plant Operator)	\$2,676.00
Robert Eastham (Plant Operator)	1,500.00
Rhonda Brandon (Office)	600.00
Janet Caldemier (Bookkeeping)	1,200.00
Richard Meier (Owner/Manager Fee)	<u>3,600.00</u>
Total	<u>\$9,576.00</u>

The salary levels listed above were approved by this Commission in Big Bear s previous rate case (Case No. 97-245) except for that of Robert Eastham. Robert and Dick Eastham are both certified wastewater plant operators and their combined annual salary was \$4,176. Based on Staff s prior experience with similarly situated small wastewater utilities, Staff is of the opinion that the salary levels included in pro forma operations are reasonable including that of Robert Eastham and recommends that they be accepted in this case.

C) Sludge Hauling. Test year sludge hauling was reported at \$2,060. This amount was excessive relative to the three prior years of operation. Sludge hauling for the years 1997, 1996, and 1995 was reported at \$800, \$0, and \$500, respectively. To normalize

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the test year expense a decreasing adjustment of \$1,220 was made so that pro forma sludge hauling equaled the average annual expense of the four years analyzed. Pro forma sludge hauling of \$840 was calculated as follows:
 $(\$2,060 + \$800 + \$0 + \$500) / 4 = \$840$.

D) Materials and Supplies. Included in test year materials and supplies expense was the cost of a motor and sand for a filter in the amounts of \$266 and \$1,157, respectively. These items are not annual expenses and should therefore be amortized. The expected life of each was determined to be five years. A decreasing adjustment to test year expenses of \$1,138 is required to reflect their five-year amortization. The adjustment was calculated as follows:

One phase motor	\$1,157.00
Filter sand	<u>266.00</u>
Total	1,423.00
Divide by: 5 years	<u>5.00</u>
Annual recovery	285.00
Less: Test year	<u>(1,423.00)</u>
Adjustment	<u>\$(1,138.00)</u>

E) Contractual Services. Test year contractual services expense included \$1,743 directly related to transferring the ownership of the wastewater treatment plant from Big Bear Resort, Inc. (Resort) to Big Bear in Case No. 98-089. That amount included legal, survey, and accounting fees of \$1,027, \$686, and \$30, respectively. The transfer of the plant was negotiated between related parties and afforded no benefit to the customers of Big Bear. Therefore, all costs related to the transfer have been eliminated from test year operations.

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Also included in test year contractual services were legal fees of \$1,691 that were paid for services related to Big Bear s previous rate case (Case No. 97-245). Rate case expense should not be an annual expense to Big Bear. Therefore, this expense has been amortized over 5 years by decreasing test year expenses by \$1,353. The adjustment was calculated as follows:

Legal fees	\$1,691.00
Divide by: 5 years	<u>5.00</u>
Annual recovery	338.00
Less: Test year	<u>(1,691.00)</u>
Adjustment	<u>\$(1,353.00)</u>

The net decreasing adjustment to contractual services was \$3,096 (\$1,743+\$1,353).

F) Insurance. Test year expenses did not include an allocation of property and workers compensation insurance. The Resort paid for these expenses. Test year expenses have been increase by \$1,589 to include their allocation. The total included \$1,218 for property insurance and \$371 for workers compensation. R. Barga & Co., Big Bear s insurance carrier, provided the allocated amounts.

G) Miscellaneous. Test year miscellaneous expenses were reported at \$477 and were increased by \$466 to calculate pro forma operating expenses. The \$466 net increase includes the following adjustments:

- 1) Land lease: On September 21, 1998, the Commission issued a Final Order in Case No. 98-089 wherein approval was granted for the Resort to transfer title of the wastewater treatment plant to Big Bear. That Order required Big Bear to file a lease agreement wherein Big Bear would lease

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the land on which the treatment plant is situated from the Resort. The lease was required because title to the land was not being transferred along with the plant. Test year expenses were increased \$600 to reflect the monthly lease payment of \$50.

- 2) Postage: Postage of \$11 was paid to deliver information regarding the transfer case (Case No. 98-089). That amount has been eliminated from test year operations. Refer to item E of this attachment for an explanation of the elimination of expenses related to this transfer case.
- 3) Bad check charge: A \$25 bad check charge was included in test year operations. This charge should be paid by the stockholders of Big Bear and has therefore been eliminated.
- 4) Big Bear maintains two checking accounts for which it paid \$196 for service charges during the test year. One checking account for a utility of Big Bear s size should be adequate. Therefore, half of the service charges, or \$98, were eliminated.

H) Depreciation. Big Bear did not record depreciation expense on the treatment plant during the test year as the title had not been transferred until the latter part of 1998. Now that the plant has been properly transferred to Big Bear, it should be allowed to recover the plant s original cost through rates.

The plant was originally purchased by Big Bear Development, Inc. (Development) from Purestream, Inc. in 1991 to replace the existing facility. The new plant was to serve Big Bear s existing and future customers. The purchase price was

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originally financed through a capital investment from the Development s stockholders. In 1992 the plant was traded to the Resort in exchange for other real property. In 1998 the Resort sold the plant to Big Bear through the negotiation of an interest bearing note payable in the amount of \$115,849.

Big Bear, the Resort, and the Development are all related parties. Big Bear would have to prove that any expenses resulting from transactions between these parties were performed at arm s-length before they could be included in pro forma operations. Staff is of the opinion that the original purchase of the plant was a prudent expenditure and should be given rate consideration. Depreciation calculated on the original purchase price should be allowed since the plant was originally funded through additional paid-in-capital and not through a contribution in aid of construction from the developer or Big Bear s customers. However, no interest expense stemming from the sale of this plant between these related parties should ever be included in revenue requirements. The interest was created through a series of related party transactions that wasn t necessary. Since the stockholders of the Development and Big Bear are the same, the interest charges could have been avoided if the capital to purchase the plant had been initially invested in Big Bear instead of the Development.

To determine the original cost of the plant to be depreciated the original purchase invoices were analyzed. Big Bear presented two invoices from Purestream that totaled \$95,064. Even though plant valued at \$155,659 was recorded in Big Bear s records as a result of the transfer case (Case No. 98-089), pro forma depreciation expense was calculated using the Purestream invoice total since that was the only amount evidenced

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by independent supporting documentation. The estimated useful life of the plant was assumed to be 20 years. The annual depreciation is therefore \$4,753 (\$95,064/20).

Since the new plant was sized to allow for future growth, the annual depreciation to be included in pro forma operations was limited to the plant capacity necessary to serve existing customers only. As new customers are added to the system and charged the rate recommended herein, additional revenue will be generated to cover the additional capacity used. The calculation is as follows:

Plant capacity (gallons per day)	35,000.00
Divide by: Gallons per day per customer	<u>400.00</u>
Maximum number of customers	88.00
Current number of customers	<u>73.00</u>
Percent of capacity reserved (73/88)	83.43%
Times: Annual depreciation	<u>4,753.00</u>
Adjustment	<u>\$3,965.00</u>

l) Taxes Other Than Income. Test year expenses have been adjusted to reflect additional payroll taxes that will be paid as a result of the salaries adjustment. The tax adjustment was calculated as follows:

Salaries adjustment	\$446.00
Times: FICA rate	<u>7.65%</u>
Adjustment	<u>\$34.00</u>

ATTACHMENT B
STAFF REPORT CASE NO. 99-114
CALCULATION OF REVENUE REQUIREMENT AND RECOMMENDED RATE

CALCULATION OF ANNUAL REVENUE REQUIREMENT

Pro forma operating expenses before taxes	25,372
Divide by: Operating ratio	<u>88%</u>
Total revenue required before taxes	28,832
Less: Pro forma operating expenses before taxes	<u>(25,372)</u>
Net income allowed after taxes	3,460
Multiply by: Tax gross up factor	<u>123.8390%</u> ¹
Net operating income before taxes	4,284
Plus: Operating expenses before taxes	<u>25,372</u>
Revenue Requirement	<u><u>29,657</u></u>

¹ Revenue	100.00000%
Less: State tax	<u>5.00000%</u>
Sub-total	95.00000%
Less: Federal tax, 15% of sub-total	<u>14.25000%</u>
Percent change in NOI	<u>80.75000%</u>
Revenue conversion factor (Revenue of 1 divided by percent change in NOI)	<u><u>123.83901%</u></u>

CALCULATION OF RECOMMENDED RATE

Revenue Requirement	\$29,657.00
Divide by: Pro forma number of bills, (60x12)+(13x8)	<u>824.00</u>
Recommended Rate	<u><u>\$35.99</u></u>