

## MEMORANDUM

### **Case No. SA-2010-0096– RDG Development, LLC**

TO: Missouri Public Service Commission Official Case File

FROM: Jerry Scheible, P.E., Utility Regulatory Engineer- Water & Sewer Department

James Russo – Water & Sewer Department

Dana Eaves – Auditing Department

Arthur Rice – Engineering and Management Services

/s/ Jerry Scheible  
Project Coordinator

October 29, 2009

/s/ Sarah Kliethermes  
Staff Counsel's Office

October 29, 2009

SUBJECT: Staff Report and Recommendation Regarding the Application Seeking Permission, Approval, and Certificate of Convenience and Necessity for RDG Development, LLC to Provide Sewer Service in a Described Area near Fulton, Callaway County, Missouri.

DATE: October 29, 2009

### **BACKGROUND**

On September 14, 2009 (unless noted otherwise, all dates herein refer to the year 2009), RDG Development, LLC (Company or RDG) filed an *Application* with the Commission, seeking a Certificate of Convenience and Necessity (CCN) to provide sewer service to the existing subdivision known as Greenwood Hills, located in Callaway County near Fulton, Missouri. There are currently thirty-three residential customer connections, all of which are to single-family homes.

On October 1, the Commission issued its *Order Directing Staff to File Recommendation*, setting an October 29 deadline for Staff to issue its Report and Recommendation in this case.

## **STAFF'S INVESTIGATION**

The area to be served was originally developed in the 1970's and the wastewater treatment lagoon was constructed and placed into operation at that time. The company is not the original developer of the subdivision, but purchased the entire development, which includes the wastewater treatment lagoon, collection system, and the remaining unsold lots in the subdivision, in 2000.

The residents of the subdivision were not billed for sewer service by any entity until RDG Development, without the authority of a CCN, billed the current residents of the subdivision for service in November of 2008. RDG billed each customer a "base rate" of \$20, plus \$5 for every 1,000 gallons of water use over 4,000 gallons, per month for the sewer service. (A partial discount was offered for customers who opted to pay for twelve months of service up front.) RDG was not aware that a CCN was required, and therefore did not submit an application for such.

The Public Service Commission (the Commission) was initially made aware of RDG's operation as a utility in December of 2008, when the Department of Natural Resources (DNR) contacted the Water and Sewer Department. Staff began investigating the situation at that point and the customers have not been billed for sewer service since the initial billing in November of 2008.

Significant effort has been made by the parties involved to determine the best solution to the situation. Although the parties initially explored various options such as the transfer of ownership of the utility to a properly formed home owners association or a different utility operating under a CCN, it was ultimately determined that RDG would apply for a CCN. This led to the submission of the application at hand. RDG Development, LLC is a corporation in good standing with the Missouri Secretary of State.

Water service is provided to the development and surrounding area by Callaway County Public Water District No. 2. The Water District does not currently operate any sewer utility.

The treatment facility consists of a two-cell lagoon with no aeration or disinfection, and operates under DNR Permit Number MO-0121274. The current permit contains a Schedule of Compliance (SOC) that requires disinfection to be added to the lagoon discharge by August of 2011. (The requirement that a Small Company Rate Case be commenced by August 31, 2011 is requested for approval in the *Staff Recommendations* section below to address the impending costs associated with meeting the SOC.) RDG has not yet submitted plans or a progress report to DNR regarding the disinfection requirement, but the lagoon is operating well within design capabilities.

Items reviewed during Staff's investigation of the subject *Application* included the Company's overall plan for providing the proposed service in the requested service area. Additionally, Staff analyzed the Company's ability to meet the "Tartan Energy Criteria," which are the criteria historically used by the Commission in evaluating CCN applications. The Tartan Energy Criteria, with criterion (1) slightly modified by Staff, are set out later in this Recommendation.

In addition to the above-referenced reviews and analysis, Staff also performed its own cost-of-service analysis and rate calculations for the system, which will be discussed in more detail later in this Recommendation.

### **THE APPLICATION AND STAFF'S REVIEWS**

Greenwood Hills Subdivision, which consists of a total of 134 lots, was originally developed in the 1970's. The main cell of the lagoon was constructed and put into operation at that time as a no-discharge facility. Over time, as homes were built and connected to the system, the lagoon could no longer be operated as a no-discharge system. In the mid-1990's, the second cell was added and the facility was reclassified to allow discharge. There are currently 33 residential customers within the subdivision. Staff and the owner of the Company expect that the additional development will continue at a relatively low level over the next few years. Therefore, Staff has assumed a customer level of 35 for ratemaking purposes.

The area is served by all-gravity collecting sewers that carry sewage from each customer's premises to the two-cell lagoon treatment facility. There are no mechanical components (grinder pumps or lift stations) on the collection system and there are no aerators or disinfection components on the lagoon. However, DNR will require a certified operator once a CCN is issued. RDG has not yet contracted with an operator, so Staff has included a reasonable salary for operations in the calculation of rates. The actual operator salary or contract, and corresponding duties, will be reviewed as part of the Small Company Rate Case recommended to be commenced by August 31, 2011.

The sewer collection pipelines will be considered contribution in aid of construction (CIAC), as is common practice in rate determination. The original cost of construction of the treatment facility and the purchase price as paid by the current owner in 2000, will be considered CIAC as well, since those costs are recouped by the subdivision developers through the sale of the lots.

There is consequently no capital investment to be considered Rate Base for the utility. Revenue Requirement was used by Staff to determine the following proposed flat rate:

#### **Residential Customers-      \$40.06/month**

Staff arrived at this rate after discussions with RDG, and modifications to the expenses as originally submitted were made. The *Rate Base, Expenses and Rate Calculation Worksheet* can

be found as “Attachment 1” and the depreciation rates used in determining rates are shown on “Attachment 2” of this Memorandum.

The Company will need to file a complete tariff after the Commission grants a certificate. Staff will assist the Company with this task, and anticipates the tariff will be similar to the Water & Sewer Department’s example tariff for sewer utilities.

### **TARTAN ENERGY CRITERIA EVALUATION**

As noted previously, Staff analyzed the Company's ability to meet the Tartan Energy Criteria, as has historically been done in evaluating certificate applications. Staff's conclusions regarding this matter are set out as follows:

**Q. Is there a need for the proposed service, and is there a need for this Company to provide the proposed service?**

A. The central sewer system is in place and serving the customers in the proposed service area, which is not located within a public sewer district’s boundaries. As a result, Staff believes there is a need for the Company to be the entity providing the sewer service to the area.

**Q. Is the Company qualified to provide the proposed service?**

A. Staff believes that the owner of the Company has demonstrated technical and managerial ability to develop and operate the sewer system, in that RDG has been doing so effectively for nine years. The owner is an established property developer, and owns and operates a building contractor business, and thereby has experience in business operation. The owner will contract with an established certified operator to run the system, or will take steps to become certified to operate the facility himself, per NDR requirements.

**Q. Does the Company have the financial ability to provide the proposed service?**

A. The initial investment in the sewer treatment facilities has been, and will continue to be, recouped in the sale of the lots and therefore does not represent a debt that remains to be paid. Staff believes that the Company has the financial capability through bank financing and its owner’s funding support to successfully move forward with its proposal, and will be able to generate sufficient cash flow to remain viable, given the proposed rates.

**Q. Is the Company's proposal economically feasible?**

A. Staff, having evaluated estimated expenses, rates, CIAC, etc., believes the proposal for the sewer system is economically feasible; if Staff's proposed rates are adopted. There is potential for numerous additional customers, which the sewer system is adequately sized to accept, which would further add to the viability of the utility.

**Q. Does the Company's proposal promote the public interest?**

A. Staff believes the Company's proposal promotes the public interest because the existing central sewer system is desirable for a good living environment for the existing residential customers, and potential additional customers as the subdivision further develops, and because the other Tartan Energy Criteria have been met.

**STAFF'S CONCLUSIONS**

Staff is of the opinion that the operation of the Company as outlined in its Application is both necessary and convenient for public service, and that the rate to be contained in the Company's tariff is just and reasonable. There is a need for sewer service, in that it is currently in operation, and therefore relied upon, for the subdivision. Staff believes the Company has the necessary technical, managerial and financial capacities, in part because the owner of the Company is an established building contractor in the vicinity and has been managing the operation of the sewer system for nine years.

**STAFF'S RECOMMENDATIONS**

Based upon the above, Staff recommends that the Commission issue an order that:

- 1) Approves a Certificate of Convenience and Necessity for RDG Development, LLC for providing sewer service to the service area described in the *Application*;
- 2) Approves the schedule of depreciation rates attached to this Memorandum for use by the Company;
- 3) Requires the Sewer Company to submit a complete tariff specifying a monthly rate of \$40.06 for residential customers. The customers will not be billed for service until such time as the tariff is approved and made effective;

- 4) Requires the Sewer Company to commence a Small Company Rate Case on or before August 31, 2011, to address the costs associated with meeting the disinfection requirement in the facility's current DNR permit Schedule of Compliance;
- 5) Requires the Sewer Company to meet the DNR requirement of retaining a certified operator within 90 days of Commission approval of the CCN;
- 6) Requires the Sewer Company to submit to the Manager of the Staff's Water and Sewer Department within 90 days of Commission approval of the CCN, a map of the subdivision that shows, at a minimum, the location of the manholes and sewer collection main lines;
- 7) Recognizes that nothing in this Memorandum, or in any order issued by the Commission in this case, shall bind the Commission on any ratemaking issue in any future rate proceedings.

After the Company submits a complete tariff, Staff will submit an additional recommendation regarding approval of the tariff.

List of Attachments

Attachment 1: Rate Base, Expenses and Rate Calculation Worksheet

Attachment 2: Schedule of Proposed Depreciation Rates

**RDG Development, LLC - MO PSC CASE NO. SA-2010-0096**  
**RATE BASE, EXPENSES AND RATE CALCULATION WORKSHEET**

**Customer Data**

**Projected Customer Totals for 2nd year of operation**

35 Single family homes: Residential customers  
 0 Commercial Customers  
 35 Total actual customers  
 35 Equivalent Customers

**Potential Customer Totals** (subdivision capacity)

134 Single family homes: Residential customers  
 0 Commercial Customers  
 134 Total actual customers  
 134 Equivalent Customers

**Requested Rates - Annual Revenues - Customer Bill**

\$71.66 Monthly Flat Rate

Annual Revenue

\$ 30,097

**Plant In Service, Rate Base and Depreciation Expense**

Description of Plant Item	Original Plant Costs	Net Plant at 10/15/09	Rate Base at 10/15/09	CIAC at 10/15/09	Depreciation/Amortization	
					Rate	Expense
Sewer System *	\$ 15,000	\$ 12,300	\$ -	\$ 12,300	4.00%	N/A
Land	\$ 5,000	\$ -	\$ -	\$ -	N/A	N/A
Pumps/Controls	\$ -	\$ -	\$ -	\$ -	10.00%	\$ -
Computer	\$ -	\$ -	\$ -	\$ -	20.00%	\$ -
Computer Software	\$ -	\$ -	\$ -	\$ -	20.00%	\$ -
Organization **	\$ 2,500	\$ -	\$ -	\$ -	20.0%	\$ 500
<b>TOTALS</b>	<b>\$ 22,500</b>	<b>\$ 12,300</b>	<b>\$ -</b>	<b>\$ 12,300</b>		<b>\$ 500</b>

Net Plant calculation based on year 2000 purchase price and assumed in-service date of 1975, with depreciation calculated accordingly.

To be amortized over 5 years beginning with issuance of certificate.

For the Company's books, the "Rate Base at 10/15/09" balances shown will be the beginning plant/rate base balances and the "CIAC at 10/15/09" balances shown will be the beginning plant/CIAC balances.

**Ratemaking Income Statement and Rate Design Allocations**

<b>Expenses -</b>		Total	Customer
Salaries (operations and mileage)		\$ 3,780	\$ 3,780
Salaries (management)		\$ 2,400	\$ 2,400
Billing and Collection		\$ 1,200	\$ 1,200
General Maintenance		\$ 500	\$ 500
Phone		\$ 480	\$ 480
Mowing - Two mowings/mo for May - Sept. and one/mo for April and Oct. @ \$200/mow		\$ 2,400	\$ 2,400
Tools, Materials and Supplies		\$ 200	\$ 200
Office Supplies and Postage		\$ 325	\$ 325
PO Box Rental		\$ 54	\$ 54
Office Rent		\$ 600	\$ 600
Tax Preparation & Accounting		\$ 1,500	\$ 1,500
Fees - Lab		\$ 480	\$ 480
Fees - MDNR		\$ 150	\$ 150
Operator Certification		\$ -	\$ -
Property Taxes		\$ 43	\$ 43
Insurance		\$ 515	\$ 515
Contingencies/Miscellaneous		\$ -	\$ -
Interest	0%	\$ -	\$ -
Return:	9.00%	\$ -	\$ -
Income Tax		\$ -	\$ -
Depreciation		\$ -	\$ -
Amortization of cost of certificate case		\$ 500	\$ 500
PSC Assessment	11.2241% of revenue	\$ 1,698	\$ 1,698
<b>Total Annual Cost of Service</b>		<b>\$ 16,825</b>	<b>\$ 16,825</b>

**Proposed Monthly Flat Rate - Customer Bill**

**Customer**  
**Charge**  
**Residential \$40.06**

**RDG Development LLC**  
**DEPRECIATION RATES**  
**(SEWER Class D)**  
**SA-2010-0096**

<b>ACCOUNT NUMBER</b>	<b>ACCOUNT DESCRIPTION</b>	<b>DEPRECIATION RATE</b>	<b>AVERAGE SERVICE LIFE (YEARS)</b>	<b>NET SALVAGE</b>
352.2	Collection Sewers (Gravity)	2.0%	50	0%
372	Oxidation Lagoons	4.0%	25	0%
373	Treatment Equipment (effluent chlorination)	5.0%	20	0%
393	Other General Equipment (tools, shop equip., backhoes, trenchers, etc.)	10.0%	9	10%



**BEFORE THE PUBLIC SERVICE COMMISSION**  
**OF THE STATE OF MISSOURI**

**AFFIDAVIT OF JERRY SCHEIBLE, P.E.**

STATE OF MISSOURI     )

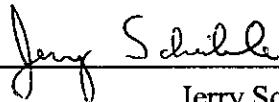
) SS

**CASE NO. SA-2010-0096**

COUNTY OF COLE     )

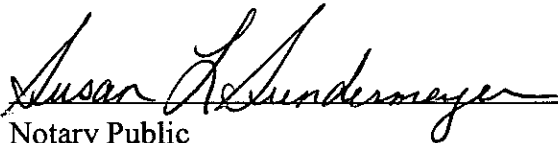
**COMES NOW** Jerry Scheible, being of lawful age, and on his oath states the following:

(1) that he is a Utility Regulatory Engineer in the Missouri Public Service Commission's Water & Sewer Department; (2) that he participated in the preparation of the foregoing Staff Report and Recommendation Memorandum; (3) that he has knowledge of the information presented in the foregoing Staff Report and Recommendation Memorandum; and (4) that the information presented in the foregoing Staff Report and Recommendation Memorandum is true and correct to the best of his knowledge, information and belief.



Jerry Scheible

Subscribed and sworn to before me this 29 day of October 2009.

  
Notary Public

My Commission Expires:

9-21-10



SUSAN L. SUNDERMEYER  
My Commission Expires  
September 21, 2010  
Callaway County  
Commission #06942086

**BEFORE THE PUBLIC SERVICE COMMISSION**  
**OF THE STATE OF MISSOURI**

In the Matter of RDG Development, LLC for     )  
a Certificate of Convenience and Necessity     )  
Authorizing it to Own, Operate, Maintain,     )  
Control and Manage a Sewer System in     )  
Callaway County, Missouri     )

Case No. SA-2010-0096

AFFIDAVIT OF ARTHUR W. RICE

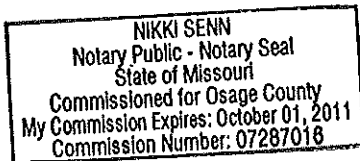
STATE OF MISSOURI     )  
                                      )     ss.  
COUNTY OF COLE     )

Arthur W. Rice, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Staff Recommendation in memorandum form, to be presented in the above case; that the information in the Staff Recommendation was developed by him; that he has knowledge of the matters set forth in such Staff Recommendation; and that such matters are true and correct to the best of his knowledge and belief.



Arthur W. Rice

Subscribed and sworn to before me this 29<sup>th</sup> day of October, 2009.





Notary Public