

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of

RED WING UTILITY CO., INC.)
APPLICATION AND PETITION)
FOR AN ORDER APPROVING UNI-)
FORM RATES FOR THE SEWERAGE) CASE NO. 7371
TREATMENT FACILITIES LOCATED)
IN HIGHLAND CLUB ESTATES)
SUBDIVISION, MAYFIELD,)
GRAVES COUNTY, KENTUCKY)

O R D E R

On August 21, 1978, Veach Plumbing Company, Inc., and Red Wing Utility Company, Inc., ("Red Wing") in Case No. 7191 filed with this Commission an application seeking a certificate of public convenience and necessity authorizing the construction of sewage collection and treatment facilities to serve approximately 28 lots located in Highland Club Estates subdivision in Graves County, Kentucky. By Order dated November 6, 1978, the Commission granted a certificate and ordered Red Wing to file an application for the establishment of initial rates.

Thereafter, on March 15, 1979, Red Wing filed with the Commission an application seeking the establishment of initial sewage service rates for Highland Club Estates subdivision. On July 10, 1979, after an evidentiary hearing in the above-styled case, the Commission issued an Order establishing an initial rate of \$25.45 per month per single-family residence for Red Wing to charge for providing sewerage service to the residents of the Highland Club Estates subdivision. Since

this was an initial rate with no customers being charged under an old rate at the time of the application, the provisions of KRS 278.185 (1) requiring notice to existing "customers" did not apply. However at the hearing of September 10, 1980, in Case No. 7568, Red Wing's application seeking authority to increase its rates for sewage treatment in the Gateway, Golden Acres, Blandville, Green Acres, Fieldmont and Holifield Estates subdivisions, several residents of Highland Club Estates testified that since their homes were already hooked-up and being provided service without charge at the time of the application to the Commission, they felt they had been deprived of their rights to intervene and oppose the rate as a result of the lack of any notice. Therefore, to insure that all affected parties feel that they have had an opportunity to be heard in this matter and in order to deal fairly and equally with all concerned, the Commission, by Order dated November 5, 1980, reopened this proceeding for new evidentiary hearings in which the residents of Highland Club Estates could participate. Further, this Order rescinded the Commission's Order entered July 10, 1979, including the rate established by that Order, set a hearing for December 4, 1980, and required Red Wing to notify each customer of the proposed hearing.

At the hearing on December 4, 1980, the previous direct testimony of Red Wing's witness and the cross-examination thereof from the June 15, 1979, hearing in this matter was

incorporated into the December 1980 hearing. In addition, Highland Club Estates' counsel moved that the testimony and record of the September 10, 1980, hearing in Case No. 7568 be incorporated into this record and considered as evidence by the Commission. As the Commission is of the opinion that testimony pertinent to this proceeding is contained in that record, the motion was sustained. Mr. Jerry Veach, Vice President of Red Wing, was also cross-examined further at this hearing. At the close of the hearing, Red Wing was given until December 15, 1980, to submit additional requested information and to allow its attorney to submit any written motions relative to the hearing. Thereafter, on December 15, 1980, Red Wing filed its motion requesting the Commission to rescind its Order dated November 5, 1980, on the basis that notice was not given prior to the issuance of the Order. The Commission, after consideration of the motion and being advised, sustained the motion, ordered the first literary paragraph of the last page of the Commission's Order entered November 5, 1980, rescinded and ordered that the Commission's Order of July 10, 1979, which set initial rates, would remain in full force and effect pending further Orders of the Commission. Red Wing has responded to all requests for additional information and the entire matter is now considered to be fully submitted for final determination by this Commission.

COMMENTARY

This agency is charged by statute with the responsibility of seeing that safe and adequate service is provided to the customers served by the public utilities in this state at a rate(s) that is fair, just and reasonable.

In fixing a reasonable rate, the Commission must examine actual test-year experience and study it to determine the reliableness of that experience as an indication of what a reasonable charge for a particular operating expense might be and what a reasonable provision for operating revenues might be.¹ At the time the initial rate was established for Highland Club Estates subdivision, however, no actual test-year experience was available as the facility had only recently been constructed. Therefore, estimated operating expenses were utilized for the determination of revenue requirements. Although actual test-year experience is now available, the Commission questions the reliableness of the financial data as it appears that the funds of Veach Plumbing and Red Wing have been commingled to some extent and the basis for allocating operating expenses common to both Red Wing and Veach Plumbing is questionable.

The Commission believes that under competent and dedicated management this accounting problem could be overcome. The Commission, however, believes the more serious problems are that of the judiciousness of certain expenditures and

¹Re. Terryville Water Company, Connecticut Public Utilities Commission, Docket No. 8606 (1952).

Red Wing's complete disregard for the financial consequences of such expenditures. Red Wing's expansion of service to new areas without regard to its ability to maintain its financial integrity and the purchase of an excavator are, in the Commission's opinion, examples of such expenditures.

For example, Red Wing's witness Jerry Veach testified that with the excavator it could construct two systems for the same price it would cost to construct one system by contract. However, no comparison or study of the cost under the two methods was provided to support this statement of the witness. Numerous customers of the utility testified that from their observations, the excavator was idle more than it was in use. Additionally, Mr. Veach does not expect any significant growth that would justify this piece of equipment prospectively. The Commission believes this type of financial management, which apparently gave no regard to the impact of expanding its service area and purchasing equipment such as the excavator on the rates of existing and future customers, is simply irresponsible. Further, Red Wing's consumers cannot be expected to pay a rate which includes the cost of any facility which has not been actually used for the production of service to those consumers.²

A further evidence of serious errors in Red Wing's financial management is the lack of prompt action by Red Wing when the customers in Highland Club Estates refused to pay

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Gulf States Utility Company V. Louisiana Public Service Commission, 364 So. 2d 1266 (1978).

their bills. Instead of pursuing appropriate legal remedies to collect the fees, Red Wing has allowed this situation to continue from July 1979 or approximately 22 months. Assuming all seven present customers were being served during this time, at the authorized rate of \$25.45 per month, this amounts to approximately \$4,000 in customer accounts receivable. In any company, but especially a small company such as Red Wing, this situation can prevent a company from continuing to operate as a viable economic entity.

A second area of immense concern to the Commission is Red Wing's failure to comply with the provisions of KRS 278.300 and Commission regulations requiring utilities to apply to the Commission for approval of securities, notes, bonds, stocks or other evidences of indebtedness payable at periods of more than two years from the date thereof. Red Wing, with the backing of the Small Business Administration (SBA), borrowed \$260,000 from the First Liberty Bank in Calvert City to, among other things, expand its existing system, build three treatment plants, buy an excavator for the utility and pay off several outstanding notes. Although when Red Wing applied for the loan they explained they would spend \$15,000 to acquire three parcels of land, information Red Wing supplied the Commission does not indicate any funds were spent for that purpose. In addition, it appears that \$15,000 to \$20,000 was spent on "operating expenses", but Red Wing did not explain which expenses were paid with the funds borrowed. This sizable,

imprudent borrowing would have been averted if Red Wing had properly sought authorization of the Commission whereby the Commission would have had the opportunity to evaluate the new indebtedness proposed by Red Wing. "It is reasonable to conclude that the company's complete disregard for the eventual financial consequences was due to its belief that any costs incurred could be passed along to the customer, without regulatory scrutiny."³

A third area of concern to the Commission is the virtual lack of maintenance performed on this sewer system and the poor service record of Red Wing. Considerable evidence was offered for the record detailing instances of poor service. One example of this was Red Wing's failure to install a lift station which it knew was required to service a Mr. Reid Hearn in Highland Club Estates. Another example of poor service was the repeated failure to keep lift stations in operation. This failure caused raw sewage to flow out of a manhole and onto the ground creating a health hazard in Highland Club Estates.

The fourth, and final, area of concern to the Commission is the future of Red Wing and its customers. We acknowledge the fact that if Red Wing is going to survive then growth must be realized. After all, the system was sized to serve the subdivision after full development and such system will be the most economical to run when utilized completely. The plant serving Highland Club Estates is rated to serve 35

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Consumers Power Company, 14 PUR 4th 1, 39 (1976).

lots. The number of customers served by the plant is seven. Red Wing, the customers served and the developers in the area all agree that an extremely high rate will halt the growth of the subdivision and insure the continued under-utilization of the treatment plant.

In reaching its conclusion that Red Wing is currently unable to provide adequate service for reasonable rates, the Commission has considered all the above facts. In establishing rates it has recognized the principle that: "A utility must be efficiently and economically managed and operated as a condition to the exercise of its right to impose rates adequate to cover the full cost of service."⁴ The Commission has also recognized that even if the financial data were acceptable, the Commission would be justified in determining lower rates than those supported by the data to be reasonable because of Red Wing's chronic poor service.⁵ In 1952, the Kentucky high court decided that the question of whether to assess a penalty rate against a public utility for providing inadequate service was essentially a question of regulatory policy within the discretion of the Commission.⁶

FINDINGS AND ORDERS

The Commission, after consideration of all the evidence of record and being advised, is of the opinion and finds that:

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Id., 43.

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Arlington Selectman V. Arlington Water Company,
394 A2d 1130 (1978).

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City of Lexington V. Public Service Commission of
Kentucky, 249 S.W. 2d 760 (1952).

1. Red Wing has failed to prove that the proposed rates are just and reasonable.

2. Approval of the rate requested would effectively eliminate future growth in Red Wing's service area, and promote the continued under-utilization of the existing treatment plant and collection system.

3. Current management has demonstrated it is not capable of operating Red Wing in an efficient, prudent and reasonable manner.

4. The third-party beneficiary agreement should be invoked because of the recurring and prolonged service problems.

5. The operation of Red Wing should be placed in the hands of the First Liberty Bank of Calvert City ("Representative") until a receiver can be appointed.

6. The Representative should begin immediately to oversee the operation of the Company and seek a competent operator for the system.

7. The Representative should continue to establish a system of accounting which clearly separates the costs of operating the sewer system from the operation of Veach Plumbing Company.

8. The Representative should pursue remedy through the proper court to recover all amounts due Red Wing by its customers for sewer service rendered from July 10, 1979 to the date of this Order.

9. Having rejected the financial data furnished by Red Wing because it is unreliable and incomplete, the best information available to the Commission regarding fair, just and reasonable rates is the rates which have been approved in recent cases for similarly-sized companies located in close proximity to Red Wing. Based on this information, the Commission finds a rate of \$15.00 per month per residential customer or residential equivalent to be reasonable. We believe this action is consistent with the line of Supreme Court decisions beginning with Federal Power Commission v. Hope Natural Gas Company, 320 US 591, 88 Led 333, 64 Sct 281 (1944), which have held that it is the end result of a rate, not the methodology used, which governs whether the rate set is reasonable.

10. Red Wing engage in no further expansion of any of its systems without prior approval of this Commission.

11. The various rate agreements referred to by developers and customers at the hearings do not bind this Commission in its function of setting just and reasonable rates. Midland Realty Company v. Kansas City Power and Light Company, 300 U.S. 109 (1936); Fern Lake Company v. Public Service Commission, 367 SW 2d 701 (1962).

12. The purchase of the excavator was not prudent nor reasonable and that costs associated with this equipment have not been considered as a part of existing rates and

should not be considered as a part of any future rates of this Company.

13. When any transaction of this Company is entered into with a related company or family member, the transaction is suspect. Red Wing did not produce any records or information supporting the proposition that transactions between the interrelated companies and owners were made at arm's length. Therefore, in the future the Company shall obtain and retain sufficient information to document the reasonableness of any such transactions.

14. This Order shall serve as notice to both Red Wing and the Representative, First Liberty Bank of Calvert City, that the Commission has invoked the third-party beneficiary agreement which provides for the Representative to take immediate possession of the sewerage system when Red Wing has defaulted in operating and maintaining it and for the Commission to seek the appointment of a receiver.

Based upon the above-stated findings, IT IS ORDERED that the proposed schedule of rates as set forth in the Commission's Order of July 10, 1979, be and the same are hereby rescinded.

IT IS FURTHER ORDERED that effective with the date of this Order, Red Wing Utility Company, Inc., is hereby authorized to place in effect the schedule of rates set out in Appendix A, attached hereto.

IT IS FURTHER ORDERED that within 20 days of the date of this Order, Red Wing through its Representative shall file its tariff sheets setting forth the rates approved herein. Further, that copies of all rules and regulations of Red Wing for providing service to customers located in the Highland Club Estates subdivision in Graves County, Kentucky, shall be filed with said tariff sheets.

IT IS FURTHER ORDERED that the First Liberty Bank of Calvert City shall immediately take possession of the sewerage system contained in Highland Club Estates subdivision, as provided in the third-party beneficiary agreement.

IT IS FURTHER ORDERED that the Representative shall provide monthly reports to the Commission showing all revenues collected and expenditures made on behalf of Red Wing Utility Company. Details shall be maintained for all expenditures.

IT IS FURTHER ORDERED that the Representative shall provide a report to the Commission showing the result of its efforts to recover those amounts due Red Wing Utility Company, Inc., by its customers for sewer service rendered from July 1979 to the date of this Order.

Done at Frankfort, Kentucky, this 15th day of May 1981.

PUBLIC SERVICE COMMISSION

Marlin W. Vohy
Chairman

Did not participate

Don Kammann
Vice Chairman
Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION IN CASE NO. 7371 DATED MAY 15, 1981.

The following rates and charges are prescribed for the customers in the area served by Red Wing Utility Company, Inc. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the date of this Order.

Applicability:

Applicable within the Highland Club Estates subdivision served by Red Wing Utility Company, Inc.

Availability of Service:

Available to all customers.

<u>Type of Service Provided</u>	<u>Monthly Rate</u>
<u>Single-Family Residential</u>	\$15.00 per Residence
<u>All Other</u>	
First 5,000 gallons	\$15.00 (Minimum Bill)
Over 5,000 gallons	1.00 per 1,000 gallons ¹

¹
Per 1,000 gallons of metered water usage. A flat-rate per month can be determined from average usage in lieu of monthly computation of this type bill.