

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

* * * * *

In the Matter of:

ADJUSTMENT OF RATES OF ERI-GEK)
SEWER TREATMENT PLANT AND FOR)
AUTHORITY TO ACQUIRE COLLECTION) CASE NO. 7899
SYSTEM AND TO EXECUTE DOCUMENTS)
NECESSARY FOR THAT PURPOSE)

ORDER

On June 27, 1980, ERI-GEK Sewer Treatment Plant (Applicant), a partnership owned by Eden Roc, Inc., and George E. Koppel, Sr., filed an application for an adjustment in its rates charged for sewer service. The proposed adjustment in rates would increase Applicant's annual revenues by \$34,992 or approximately 95%. Applicant stated that this adjustment was necessary to permit it to operate on a sound financial basis and to provide adequate service to its customers.

In order to determine the reasonableness of the proposed rates, the Commission by order dated August 13, 1980, scheduled a public hearing to be held December 16, 1980. The hearing was held as scheduled with the Attorney General's Division of Consumer Intervention, Half Moon Apartments Partnership, and Brookside Apartments being present and intervening in this matter.

On January 15, 1981, Applicant filed an amended application requesting authority to acquire, at no cost, the collection system used in the service of its customers but presently owned by the individual partners. A second hearing in this matter was

held on March 18, 1981, with all parties of interest being present. The matter of the proposed increase in rates is now considered submitted for final determination by the Commission.

TEST PERIOD

Applicant proposed and the Commission has accepted the twelve (12) months ending March 31, 1980, as the test period in this matter. Pro forma adjustments when found reasonable have been included to more clearly reflect current operating conditions.

VALUATION METHOD

Applicant proposed as its valuation method to use a net investment rate base approach. The Commission after consideration of this alternative finds that in this instance it is more appropriate to use the operating ratio method in the determination of rates as Applicant's proposed rate base includes accounting valuations and methods that are not acceptable for rate-making purposes.

Moreover, the Commission has used the operating ratio method as the basis in determining sewer rates for the past several years and finds that the results of this method have been reasonable and fair to both owners and ratepayers. Any consideration of return requires judgement and the use of a net investment basis is no more scientific nor accurate than a valuation based on the operating ratio. Therefore, the Commission, after consideration of various methods, will use the operating ratio method as follows:

$$\text{Operating Ratio} = \frac{\text{Operating Expenses} + \text{Depreciation} + \text{Taxes}}{\text{Gross Revenues}}$$

REVENUES AND EXPENSES

Applicant's income statement for the period ending March 31, 1980, showed operating expenses (including interest expense of \$5,870) of \$36,400. From this actual expense the Commission has excluded property taxes not applicable to utility operations of \$1,176⁽¹⁾ and the effects of Applicant's use of an accelerated depreciation method amounting to \$678,⁽²⁾ which is unacceptable for rate-making purposes.

The Commission has further made an additional adjustment to reduce Applicant's expenses by \$1,263⁽³⁾ which is related to Applicant's excess capacity in the system. Testimony in the record established that Applicant had requested approval from the Louisville Board of Health to serve two large apartment complexes planned for construction in Applicant's service area. It was, moreover, established in the record of evidence that the capacity of the system is 200,000 GPD⁽⁴⁾ and that the present demand on the system is approximately 157,700 GPD⁽⁵⁾. The Commission finds that it is, therefore, unfair to require the present users

(1) Transcript of Evidence of March 18, 1981, page 121-122, questions and responses 1-3.

(2) Applicant Exhibit X, Per Books less Straight Line (\$5,710 - \$5,032 = \$678).

(3) Calculation:

| | <u>Book Amount</u> | <u>Excess Capacity*</u> | <u>Adjustment</u> |
|----------------|--------------------|-------------------------|-------------------|
| Depreciation | \$ 5,032 | .10575 | \$ 532 |
| Property Taxes | 1,044 | .10575 | 110 |
| Interest | 5,870 | .10575 | 621 |
| Total | <u>\$11,946</u> | | <u>\$1,263</u> |

* $200,000 \text{ GPD} - 157,700 \text{ GPD} = 42,300 \text{ GPD} \div 200,000 = .2115 \div 2 = .10575$

(4) Transcript of Evidence of December 16, 1980, page 69, response 2.

(5) Transcript of Evidence of December 16, 1980, page 70, response 6.

of the system to pay the total cost of this excess capacity especially since new users are likely to be served from the plant in the foreseeable future. However, the Commission also recognizes that as these apartment complexes are not under construction at present, it may be several months before the financial burden to the owners is alleviated and in the meantime the plant must be operated in a satisfactory manner. Therefore, the Commission has decided in fairness to all parties concerned that the costs associated with the excess capacity shall be shared equally by the owners and the ratepayers.

Moreover, Applicant proposed several pro forma adjustments to its income statement. The Commission is of the opinion that these adjustments are generally proper and has accepted them for rate-making purposes with the following exceptions:

(1) Administrative and General Salaries:

Applicant proposed administrative and general salaries and related payroll taxes of \$7,200 and \$645, respectively. Based on testimony concerning the work performed by the individual employee and the hours devoted to the utility's operations, the Commission is of the opinion that these amounts are excessive. The Commission has allowed administrative and general salaries and related payroll taxes of \$3,600 and \$356, respectively, and will not consider for rate-making purposes salaries and payroll taxes exceeding these amounts in this proceeding.

(2) Reserve Fund:

A reserve fund in the amount of \$2,000 was requested by Applicant for short-lived plant and equipment. The Commission

has disallowed this reserve fund as it is no longer considered an appropriate expense item for rate-making purposes. In general, the Commission finds that utilities fail to properly administer and maintain this fund and further finds that capital needs for plant replacement should be borne by the partners.

(3) Electricity Costs:

Applicant moved that the record of evidence be amended to show pro forma power cost of \$9,900 during the second hearing in this matter. The Commission has further adjusted power cost to \$11,149 based on known and measurable rates for Louisville Gas and Electric effective September 24, 1980.

(4) Rate Case Expenses:

Pro forma rate case expense of \$3,830 was amortized over a three-year period by Applicant in its original application; however, it moved that the record of evidence be amended to a two-year period. The Commission, in accordance with policy and historic experience with sewer utilities, has amortized rate case expense over a three-year period for an annual allowance of \$1,277.

Therefore, Applicant's test-period operations are adjusted as follows:

| | <u>Per Books</u> | <u>Adjustments</u> | <u>Adjusted</u> |
|----------------------|------------------|--------------------|-----------------|
| Operating Revenues | \$36,737 | \$ 0 | \$36,737 |
| Operating Expenses | 30,530 | 1,182 | 31,712 |
| Net Operating Income | \$ 6,207 | \$(1,182) | \$ 5,025 |
| Interest Expense | 5,870 | (950) | 4,920 |
| Net Income | \$ 337 | \$ (232) | \$ 105 |

The Commission is of the opinion that a fair, just and reasonable operating ratio is 88% in that it will permit the Applicant to pay its operating expenses, service its debt and

provide a reasonable return to Applicant's owners. Therefore, the Commission finds that Applicant is entitled to increase its rates to produce total revenues of \$40,956 or an increase in revenues of \$4,219.

TRANSFER OF COLLECTION LINES

As previously mentioned, Applicant petitioned the Commission in its amended application for authority to acquire collection lines at no cost from the individual partners of ERI-GEK. The Commission at this time will not render a decision on the acquisition of the collection lines as the evidence of record on this issue and the related issue involving capacity fees charged by the individual partners is lengthy and may require further investigation.

SUMMARY

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

1. The Applicant has filed with this Commission a valid third-party beneficiary agreement.
2. The rates set forth in Appendix A, attached hereto and made a part hereof, are the fair, just and reasonable rates to charge for sewage service rendered by ERI-GEK Sewer Treatment Plant in that it will permit Applicant to meet its reasonable operating expenses and to accumulate a reasonable surplus for equity growth.
3. The rates proposed by Applicant are unfair, unjust and unreasonable in that they would produce revenues in excess of those found reasonable herein and should be denied.

4. The issue involving the transfer of the collection lines will not be decided herein.

IT IS THEREFORE ORDERED, that the rates set forth in Appendix A, attached hereto and made a part hereof, are the fair, just and reasonable rates to charge for sewage service rendered by ERI-GEK Sewer Treatment Plant on and after the date of this Order.

IT IS FURTHER ORDERED, that the rates proposed by Applicant are unfair, unjust and unreasonable in that they would produce revenues in excess of those found reasonable herein and should be denied.

IT IS FURTHER ORDERED, that ERI-GEK Sewer Treatment Plant shall file with this Commission within thirty (30) days from the date of this order its current rules and regulations and its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 27th day of April, 1981.

PUBLIC SERVICE COMMISSION

Marlin M. Vohy
Chairman

Did not participate
Vice Chairman

Ann Karpig
Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION IN CASE NO. 7899 DATED
APRIL 27, 1981

The following rates are prescribed for sewage disposal services rendered to customers of the ERI-GEK Sewer Treatment Plant located in Fordham, Brookside and Half Moon subdivisions in Jefferson County, Kentucky.

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.

TYPE OF SERVICE

MONTHLY CHARGE

Single Family Dwellings, Apartments
and Small Commercial Customers

\$ 6.75 per Month

Y.M.C.A.

270.00 per Month