

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

AN ADJUSTMENT OF RATES OF)
CONFEDERATE ACRES SANITARY) CASE NO. 8719
SEWER AND DRAINAGE SYSTEM, INC.)

O R D E R

On October 29, 1982, Confederate Acres Sanitary Sewer and Drainage System, Inc., ("Confederate Acres") filed its notice with the Commission wherein it proposed to increase its rate for sewer service rendered on and after December 1, 1982. The proposed rate would produce an increase in gross annual revenues of approximately \$31,105, or 77 percent above test period revenues. In this Order the Commission has allowed a rate to produce an increase in revenues of \$12,947.

The Commission suspended the proposed rate for 5 months after December 1, 1982, and held a public hearing on January 27, 1983. The Consumer Protection Division of the Attorney General's Office ("AG") was permitted to intervene and participate in the public hearing. Further, the Commission allowed Mr. Paul Holliger, a customer of Confederate Acres, to make a statement for the record and to file a petition on behalf of several of the customers of Confederate Acres.

On February 10, 1983, Confederate Acres filed a memorandum setting out its position on certain issues in the case. The AG filed a reply to Confederate Acres' memorandum on February 22, 1983. All information requested has been submitted.

TEST PERIOD

Confederate Acres proposed and the Commission has accepted the 12-month period ending July 31, 1982, as the test period in this case.

REVENUES AND EXPENSES

Confederate Acres proposed several pro forma adjustments to its actual test period operating revenues and expenses. The Commission finds these adjustments reasonable and has accepted them for rate-making purposes with the following exceptions:

Management Fee

Confederate Acres' test period expenses included \$4,000 compensation for management services. All routine maintenance operations are performed by Loyie Allen Developers and Builders, Inc., ("Allen Developers") and all billing and collection is performed by the Louisville Water Company. Thus, the functions performed by Confederate Acres' management are limited to part-time administrative duties.

In its Order entered June 6, 1979, in Confederate Acres' last rate case, the Commission allowed a management fee of \$1,800.¹ Confederate Acres has not presented any proof in this case that management's duties have changed since the last case. Therefore, based on its experience with other similarly-operated sewer utilities, and with no further proof submitted by Confederate Acres regarding any change in management's duties, the Commission is of the opinion that \$4,000 for management services is excessive and should be reduced to a more reasonable level of \$2,400, which reflects the approximate change in inflation since June 1979 as measured by the Consumer Price Index ("CPI").²

Routine Maintenance Service Fee

The Commission has reduced the pro forma routine maintenance service fee of \$9,600 per year to the actual test period expense of \$8,100. The \$1,500 adjustment proposed by Confederate Acres was based on a bid of \$800 per month submitted by Andriot Davidson Service Company to perform this service. Mr. Loyie Allen, president and owner of Confederate Acres, testified that he had not accepted the bid from Andriot Davidson,³ and thus the proposed adjustment is not known and measurable at this time.

Repairs

An analysis of individual invoices of test period repair expenses of \$5,722 showed that during the test period Confederate Acres made major improvements which extended the life of its sewer plant. Confederate Acres replaced a 7-1/2 HP submersible pump for \$1,395, replaced a comminuter for \$880, and replaced a roots rotary lobe blower for \$1,117.⁴ The Commission considers these replacements to be capital items and has therefore reduced repair expenses accordingly.

Depreciation Expense

The Commission has increased test period depreciation expense by \$1,131⁵ to allow depreciation on the capital items excluded from repair expenses described above. This adjustment reflects an expected useful life of 3 years.

Further, in its analysis of Confederate Acres' depreciation schedule for the test period, the Commission found that Confederate Acres had used the straight line remaining-life depreciation method to compute its depreciation expense for both book and tax purposes.⁶ Remaining-life is an

accelerated method of depreciation recovery which results in greater amounts of depreciation being charged in the earlier years of an asset's useful life with a corollary reduction in income tax liabilities. From an analysis of Confederate Acres' past records, it appears that remaining-life has been consistently used for both book and tax purposes and that income tax expense has been recorded as the actual liability which has effectively flowed through the benefits of tax depreciation charges to the ratepayers.

Under the Uniform System of Accounts for Sewer Utilities adopted by this Commission, depreciation should be recorded on the straight line whole-life basis for book purposes. Since depreciation and tax expense in the past have been calculated on the same basis, the ratepayers have not been affected and the Commission will not require retroactive adjustments to Confederate Acres' books of account. However, the Commission has in this Order increased Confederate Acres' depreciation expense by \$3,593⁷ to reflect the proper amount to be recorded under the whole-life method and in a further adjustment has correspondingly reduced taxable income by this amount. Confederate Acres should, in future financial reports for book purposes, adopt the straight line whole-life method of depreciation.

Excess Plant Capacity Adjustment

The Commission has made an adjustment to reduce Confederate Acres' expenses by \$2,601⁸ related to excess capacity in the sewer system. Testimony was introduced in the record by Mr. Allen that described additions made to the sewer plant for the expansion of the original treatment plant and collection lines during the period from October 1972 through October 1977 which totaled \$61,930.⁹ These additions were made

with the expectation of serving additional customers from the sale of lots owned by Allen Developers, which has not occurred. The cost of these additions is further documented by the depreciation schedule.

The Commission finds that it is unfair to require the present users of the system to pay the total cost of this excess capacity. However, the Commission also recognizes that it may be some time 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 should be shared equally by the owners and the ratepayers.

Judgment Expenses

Confederate Acres proposed to include \$11,258 in its test period operating expenses for the costs associated with a judgment of \$18,036 against it plus all related expenses of the lawsuit including accrued interest and legal fees of \$15,739 amortized over a 3-year period. The lawsuit was filed in Jefferson Circuit Court by several customers of Confederate Acres against the Metropolitan Sewer District, Hall Construction Company and Confederate Acres and involved property damages resulting from the back-up of water in the houses of the people who filed suit. The jury found Confederate Acres negligent and thus liable for a portion of the total damages awarded of approximately \$130,000.

In the hearing held January 27, 1983, in this case, Confederate Acres was advised of the Commission's policy regarding the disallowance of judgments and related expenses for rate-making purposes. In both Mountain Utilities, Inc., ("Mountain") Case No. 8425, and Union Light, Heat and

Power Company, Case No. 8373, the Commission held that extraordinary expenses due to negligence on the part of the utility should be the stockholders' responsibility and not that of the ratepayers.

Confederate Acres was unfamiliar with the Commission's policy at the time of the hearing and was thus permitted to file a memorandum regarding its opinion on this issue. The AG moreover filed a reply memorandum.

Confederate Acres in its memorandum advanced several arguments which should be addressed herein. First, Confederate Acres states that the judgment in this case can be distinguished from the Mountain case in that the damages in the present case, which followed an unusually heavy downpour of rain, were caused by an Act of God and can be distinguished from a gas explosion. The Commission is not in a position to disagree with the jury in the Confederate Acres lawsuit which found Confederate Acres to be negligent. Thus, in the Commission's opinion there exists no difference in the circumstances.

Second, Confederate Acres states that in theory accidents will happen, are to be expected and should be treated as an expense of doing business. Confederate Acres further states that the Commission allows other utilities either liability insurance or other expenses for injuries and damages. It is Confederate Acres' claim that since the Commission allows liability insurance expenses, it should allow amortization of an actual liability incurred when no insurance premiums have been included in rates. Moreover, Confederate Acres' asserts that,

"Chances are, such an expense has been included in every major case which has been ruled upon by the Commission ...since provision for such an expense is provided for in the Uniform System of Accounts for the various types of utility companies. Any difference in the manner of treatment merely because of the size of the utility would obviously be unlawful discrimination."¹⁰

The Commission would have included the cost of insurance premiums in the rates had Confederate Acres been expending reasonable amounts for said insurance. However, Confederate Acres did not have liability insurance coverage and has not provided proof of the annual cost of a reasonable level of liability insurance. Further, under proper management, Confederate Acres could have provided self-insurance for this liability by setting aside a reasonable reserve for injuries and damages in Account 262, as provided in the Uniform System of Accounts for Sewer Utilities. The Commission would have also accepted reasonable self-insurance charges in past cases for rate-making purposes. However, no such provision was made nor was a reasonable level ever determined. It is, therefore, the Commission's position that the stockholders and management of Confederate Acres ignored potential risks of accident and should not be compensated for their lack of foresight at the ratepayers' expense. In its next rate case filing, Confederate Acres may apply for rates to cover either liability insurance premiums or reasonable self-insurance charges.

The Commission carefully reviews the expenses of major utilities in their rate case filings. There is no difference in the Commission's policy with regard to large and to small utilities. If, as Confederate Acres alleges, judgment damages have been included in the rate-making expenses of a major utility, this resulted from oversight and not discrimination.

Confederate Acres argues that without recovery of the judgment expenses, it cannot meet its customers' needs because of its financial plight. This is not a valid argument for requiring the ratepayers to absorb these unreasonable costs caused by both poor planning and

negligence. The Commission is obligated to consider the fairness to all parties concerned and finds it inappropriate to impose these extremely high charges on the customers, many of whom were parties in the lawsuit, simply to bail out the present owners. If the quality of service declines, the Commission may be required to take other legal remedies to ensure adequate service to the customers.

Agency Collection Fee

Confederate Acres projected expenses of \$1,538 related to the collection of its bimonthly sewer bill by the Louisville Water Company. The Commission has made an adjustment of \$670¹¹ to increase this expense to reflect the apportionment of the joint service cost of the collection agency for each bimonthly bill of the customer which includes the charge for both water and sewer service.

Therefore, Confederate Acres' adjusted operations at the end of the test period are as follows:

	<u>Per Books</u>	<u>Commission Adjustments</u>	<u>Commission Adjusted</u>
Operating Revenues	\$40,319	\$ -0-	\$40,319
Operating Expenses	37,193	1,388	38,581
Operating Income	<u>\$ 3,126</u>	<u>\$(1,388)</u>	<u>\$ 1,738</u>
Interest Expense	\$ 6,544	\$ 1,297	\$ 7,841
Net Income (Loss)	<u>\$(3,418)</u>	<u>\$(2,685)</u>	<u>\$(6,103)</u>

REVENUE REQUIREMENTS

The Commission is of the opinion that Confederate Acres' adjusted operating loss is unfair, unjust and unreasonable. The Commission is further of the opinion that an operating ratio of 88 percent is fair, just and reasonable in that it will allow Confederate Acres to meet its

operating expenses, service its debt and provide a reasonable return to its stockholders. Therefore, the Commission finds that Confederate Acres should be permitted to increase its rates to produce an increase in annual revenue of \$12,947,¹² which includes income taxes of \$1,393.

OTHER ISSUES

Future Repairs

Confederate Acres wishes to make certain major repairs to its sewer system in the near future. Confederate Acres provided a list of the needed equipment totaling approximately \$10,670. While the Commission recognizes that these expenditures may be necessary in the operation of the sewer system, Confederate Acres has not obtained the appropriate financing. Therefore, the Commission cannot provide revenue in this Order for financing the proposed expenditures. Further, the Commission advises Confederate Acres to make application for approval of such financing when the arrangements are complete.

Repair Parts Inventory

A review by the Commission of invoices issued by Allen Developers for repair work performed for Confederate Acres shows that a mileage allowance of approximately \$25 is charged for each trip made to purchase repair parts for the sewer system. The Commission recommends that Confederate Acres maintain a reasonable supply of needed repair parts to reduce this cost, which could become excessive.

SUMMARY

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

1. The rate proposed by Confederate Acres would produce revenues in excess of the revenues found reasonable herein and should be denied upon application of KRS 278.030.

2. The rate in Appendix A is the fair, just and reasonable rate to charge for sewer service rendered to Confederate Acres' 316 customers and should produce annual revenues of approximately \$53,266.

3. Confederate Acres has on file with this Commission a valid third party beneficiary agreement which was submitted in Case No. 7374.

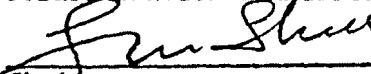
IT IS THEREFORE ORDERED that the rate in Appendix A be and it hereby is fixed as the fair, just and reasonable rate of Confederate Acres to become effective for sewer service rendered on and after May 1, 1983.

IT IS FURTHER ORDERED that the rate proposed by Confederate Acres be and it hereby is denied.

IT IS FURTHER ORDERED that, within 30 days of the date of this Order, Confederate Acres shall file with this Commission its tariff sheets setting forth the rate approved herein and a copy of its rules and regulations for providing sewer service.

Done at Frankfort, Kentucky, this 2nd day of May, 1983.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary

Footnotes

¹ Order entered June 6, 1979, Case No. 7374, Appendix C.

² CPI-W, June 1979: 216.9
 CPI-W, February 1983: 292.3
 % Change - 34%

³ Transcript of Evidence ("T.E."), January 27, 1983, pages 57 and 58.

⁴ Invoices included in response to PSC Order dated December 8, 1982:

<u>Invoice Date</u>	<u>Invoice Number</u>	<u>Vendor</u>	<u>Item</u>	<u>Cost</u>
10/14/81	12813	Allen Developers	Submersible Pump	770.00
10/12/81	02752	Louisville Pump Co.	Submersible Pump	624.75
7/12/82	12804	Allen Developers	Comminuter	498.50
7/12/82	8410	Custom Welding, Inc.	Comminuter	381.50
7/29/82	12804	Allen Developers	Rotary Blower	525.00
7/29/82	00546	Custom Welding, Inc.	Rotary Blower	592.00

⁵ \$3,392 ÷ 3 years = \$1,131.

⁶ Response to the Commission's Order filed January 3, 1983.

⁷ Calculated using Confederate Acres' useful lives on a whole-life basis from the depreciation schedule. Response to the Commission's Order filed January 3, 1983.

⁸ Calculation:

	<u>Book Amount</u>	<u>Excess Capacity**</u>	<u>Adjustment</u>
Depreciation	\$ 6,411*	38.6% ÷ 2	\$1,237
Property Taxes	521	38.6% ÷ 2	101
Interest	6,544	38.6% ÷ 2	1,263
Total	<u>\$13,476</u>		<u>\$2,601</u>

*PSC adjusted book amount based on the whole-life method of depreciation.

**\$61,930 (Additions) ÷ \$160,280 (Total Plant) = 38.6%.

⁹ T.E., January 27, 1983, pages 100 through 105.

¹⁰ Confederate Acres Memorandum, filed February 10, 1983, pages 3 and 4.

¹¹ \$1.72 X 67.71% X 316 X 6 = \$2,208 - \$1,538 = \$670.

¹² \$39,974 ÷ 88% = \$45,425 + \$7,841 - \$40,319 = \$12,947.

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION IN CASE NO. 8719 DATED MAY 2, 1983

The following rate is prescribed for customers served by Confederate Acres Sanitary Sewer and Drainage System, 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 effective date of this Order.

RATE (monthly)

Residential

\$14.05