

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

AN ADJUSTMENT OF RATES OF)
TREE-LINE UTILITIES, INC. D/B/A) CASE NO. 9100
TREE-LINE ESTATES SEWAGE)
TREATMENT PLANT)

O R D E R

On July 13, 1984, Tree-Line Utilities, Inc., d/b/a Tree-Line Estates Sewage Treatment Plant ("Tree-Line Estates") filed an application with the Commission to increase its sewer rate pursuant to 807 KAR 5:076. This regulation permits utilities with 400 or fewer customers or \$200,000 or less gross annual revenues to use the alternative filing method to minimize the necessity for formal hearings, to reduce filing requirements and to shorten the time between the application and the Commission's final Order. This procedure minimizes rate case expenses to the utility and, therefore, results in lower rates to the ratepayers.

Tree-Line Estates requested rates to produce an annual increase of \$31,250. In this Order, the Commission has granted rates to provide additional revenues of \$15,135.

TEST PERIOD

The Commission has accepted the 12-month period ending December 31, 1983, as the test period in this case.

REVENUES AND EXPENSES

Tree-Line Estates had a net operating loss of \$14,998 for the test period. In order to reflect current operating conditions, Tree-Line Estates proposed numerous adjustments to expenses resulting in a net operating loss of \$18,048. The appropriate level of net operating loss as determined by the Commission is \$7,247.

The Commission has accepted Tree-Line Estates' pro forma revenues and expenses with the following adjustments:

Revenue Normalization

For the test period, Tree-Line Estates had operating revenue of \$18,899 from 194 customers. The Commission has increased operating revenue by \$685 to reflect normalized annual revenue based on the number of customers at test year end for total operating revenue of \$19,584.

Electricity Expense

During the test period Tree-Line Estates incurred purchased power expenses of \$10,057 which it proposed to increase to \$10,807. Using the actual test-year electric usage and the current rates being charged by its supplier, the Louisville Gas and Electric Company, the Commission has determined the adjusted level of this expense to be \$11,175 and has, therefore, increased Tree-Line Estates' pro forma expense by \$368.

Chemicals Expense

According to the 1983 Annual Report, Tree-Line Estates incurred chemicals expense of \$621. A review of the invoices for chemicals expense indicated that, of the amount expended in 1983,

\$402 was incurred during 1982 and should not have been included in test year expenses; therefore, the Commission has reduced chemicals expense by \$402.

Depreciation Expense

Tree-Line Estates requested increased depreciation expense of \$2,000 for various repairs performed by Andriot-Davidson's Service Company, Inc., ("Andriot-Davidson") which Tree-Line Estates proposed to capitalize and depreciate over 10 years. In response to a Commission request, Tree-Line Estates indicated that repairs of the tertiary lagoon in the amount of \$9,747 had been delayed because of lack of funding and because of discussions with the Metropolitan Sewer District, which is seeking to acquire Tree-Line Estates. The Commission has therefore reduced the pro forma depreciation expense by \$975¹ related to the repairs of the tertiary lagoon because this expense is not yet a known and measurable adjustment, since the repairs have not occurred as of the date of this Order.

Routine Maintenance Service Fee

Tree-Line Estates reported Routine Maintenance Service expense of \$4,800 for the test period and proposed no adjustment to this expense. Since the contract is between mutually-owned companies, Tree-Line Estates and Andriot-Davidson, the transaction is, by definition, at less-than-arms-length. Therefore, the burden of proof is on Tree-Line Estates to demonstrate that the

¹ $\$9,747 \div 10 \text{ years} = \$9,74.7 \text{ or } \$975.$

monthly charge for routine maintenance service is fair, just and reasonable.

In support of the fee charged by Andriot-Davidson, Tree-Line Estates provided a list showing hourly mechanics' labor charges at several car dealerships.² However, this information is irrelevant since no evidence was provided as to why the Commission should consider the wages of auto mechanics when determining the reasonableness of transactions between mutually-owned companies involving the fees for maintenance of sewage treatment plants.

In evaluating the reasonableness of the routine maintenance service fee in cases involving sewer utilities the Commission often compares the present fee to the level of this fee which was found reasonable in previous Commission Orders. In this instance, Tree-Line Estates' most recent rate Order in Case No. 7500³ issued on November 13, 1979, allowed a routine maintenance service fee of \$1,200 per year. A review of Tree-Line Estates' annual reports since 1979 indicates that Tree-Line Estates has experienced little, if any, increases in its customer base and that Tree-Line Estates has made only minor additions to plant since the Commission's Order was entered in the previous rate case. Furthermore, there is no evidence to indicate that the

² Response filed March 18, 1985, to Information Request of February 6, 1985.

³ The Application for a Certificate of Convenience and Necessity and the Establishment of Sanitary Sewer Rates for the Tree-Line Estates Subdivision Project (Formerly Pirouette Manor) Jefferson County, Kentucky.

increases in this fee above the \$1,200 expense found reasonable in November 1979 are related to increased levels of service provided by Andriot-Davidson.

It is the responsibility of this Commission to determine whether Tree-Line Estates has shown its expense for routine maintenance service to be fair, just and reasonable. Based on the evidence of record, the Commission is of the opinion that Tree-Line Estates has failed to make such a showing. Therefore, the Commission has made an adjustment which reflects a level of expense found reasonable in its previous rate proceeding. Such adjustment reflects an annual expense level of \$1,200 or a decrease of \$3,600 from the actual test year expense. In making this adjustment, the Commission recognizes that this case was an ARF proceeding in which a hearing was not held. Therefore, Tree-Line Estates is hereby apprised that the Commission will consider a motion for a formal hearing on this matter should Tree-Line Estates indicate that it intends to submit persuasive proof in support of its test year expense for routine maintenance service.

Interest Expense

Tree-Line Estates incurred interest expense on long term debt of \$5,319 for the test period. This interest expense relates to a lease agreement between Tree-Line Estates and Citizens Fidelity Bank which was entered into in October 1981. A review of Commission records indicates that Tree-Line Estates has never requested Commission authorization for this particular indebtedness, in violation of KRS 278.300 which requires that:

No utility shall issue any securities or evidences of indebtedness, or assume any obligation or liability in respect to the securities or evidences of indebtedness of any other person until it has been authorized to do so by order of the Commission.⁴

In response to an information request,⁵ Tree-Line Estates contended that the debt in question was authorized by the Commission in Case No. 8093.⁶ Tree-Line further stated that the proceeds from the lease in the amount of \$46,000 were used to pay off a previous loan from Baldwin-United Mortgage Company ("Baldwin-United") and to make improvements to Tree-Line Estates' tertiary lagoon.

The Commission's review of Tree-Line Estates' previous cases indicates that in Case No. 8093 dated May 29, 1981, the Commission approved the purchase of Tree-Line Estates by Tree-Line Utilities, Inc., from Baldwin-United, the purchase being contingent upon the execution of a \$25,000 note payable by Tree-Line Estates to Baldwin-United. The Commission in its Order in Case No. 8093 recognized that the proceeds of the note would be used to finance the construction necessary to increase the capacity of the treatment plant, as was approved in Case No. 7500. However, the information filed in this case reveals that

⁴ Kentucky Public Service Commission Law, Kentucky Revised Statutes, Chapter 278.

⁵ Response filed November 9, 1984, to October 23, 1984, request.

⁶ Application of Tree-Line Utilities, Inc., d/b/a Tree-Line Estates Sewer System for Authority to Acquire and Operate the Tree-Line Estates Sewer System Currently Operated by Baldwin-United Mortgage Company.

Tree-Line Estates in October of 1981 entered into a separate agreement with Citizens Fidelity, without Commission approval, to borrow \$46,000 in order to pay off Baldwin-United and to make additional improvements to its tertiary lagoon.⁷ The record in this case and that of Case No. 8093 also reveals that Andriot-Davidson performed the construction and installation of equipment to Tree-Line Estates, the price of which was bid at \$34,378 to Tree-Line Estates by letter dated July 21, 1980, but which was subsequently sold on account to Tree-Line Estates at a price of \$39,525; and that Tree-Line Estates subsequently sold this installation to Citizens Fidelity and leased it back for the proceeds of \$46,000.⁸

The Commission notes that had the original 3-year loan from Baldwin-United issued in July 1980 expired in 1983, the interest expense related to that loan would not be included in this rate case. Moreover, the Commission emphasizes that approval was not sought for any of the financing arrangements and related transactions made by Tree-Line Estates subsequent to the approval granted in Case No. 8093. Because the Commission recognized in Case No. 7500 that modifications to the plant were necessary and allowed the purchase and related obligation to Baldwin-United in Case No. 8093, the Commission will allow interest expense on the original note payable in the amount of \$25,000, figured at the

⁷ Ibid.

⁸ See response filed March 18, 1985, to information requested on February 6, 1985.

prime rate plus 2 percent⁹ for the test period. This results in an allowable interest expense of \$3,197,¹⁰ a reduction in test period interest expense on long term debt of \$2,140. Although the Commission has adopted this position herein the Commission advises Tree-Line Estates that total disallowance of interest expense would not be unjustified in future instances where Commission authorization to enter into an indebtedness is neither sought nor granted.

Maintenance Expense

Tree-Line Estates' test period operations included \$6,148 for maintenance of the treatment and disposal plant. An analysis of the individual invoices for the test period indicated that Tree-Line Estates expensed \$4,941 for repairs which were non-recurring in nature, benefiting more than one economic period and therefore capital items. The Commission has therefore reduced the test period maintenance expense by \$4,941 and has allowed depreciation on the items in question in the amount of \$596,¹¹ a net adjustment of \$4,345.

Miscellaneous General Expenses

Tree-Line Estates incurred miscellaneous general expenses of \$1,085 for the test period. In response to a Commission

⁹ The terms of the agreement with Baldwin-United called for the prime rate plus 2 percent. The average prime rate for 1983 according to the Federal Reserve Statistical Release was 10.79 percent.

¹⁰ $\$25,000 \times .1279 = \$3,197$

¹¹ See Appendix B.

request,¹² Tree-Line Estates submitted invoices indicating that these expenses were late payment charges from an associated company, Andriot-Davidson. The Commission notes that Tree-Line Estates has not requested rate relief since initial rates were awarded in the Order in Case No. 7500, dated November 13, 1979. The burden of obtaining sufficient revenues to pay operating costs rests with the management of Tree-Line Estates. The failure of Tree-Line Estates to seek sufficient revenues to cover its operating costs in prior periods does not justify the recovery of those costs from the present ratepayers. To allow Tree-Line Estates to recover these costs would constitute retroactive rate-making. Therefore, as the Commission is of the opinion that the late payment charges were incurred as a result of Tree-Line Estates' failure to seek adequate rate relief in the past, these expenses have been disallowed.

Insurance Expense

Tree-Line Estates reported insurance expense of \$392 for the test period. In response to a Commission request,¹³ Tree-Line Estates submitted an invoice in the amount of \$315 for insurance expense. Because Tree-Line Estates did not provide substantiation for the difference of \$77, the Commission has only allowed insurance expense of \$315.

¹² See response to information request filed November 26, 1984, Item 10.

¹³ See response filed March 18, 1985, Item 5.

Other Interest Expense

Tree-Line Estates reported other interest expense of \$110 for the test period. In response to a Commission request¹⁴ Tree-Line Estates stated that this amount represented interest expense on a loan from the Carroll Cogan Companies Special Loan Account and that the loan was taken out to retire current payables. As explained in the previous section, allowing this interest expense would constitute retroactive rate-making and it has therefore been disallowed for rate-making purposes.

Therefore, Tree-Line Estates' adjusted operations at the end of the test period are as follows:

	<u>Pro Forma Requested</u>	<u>Commission Adjustments</u>	<u>Commission Adjusted</u>
Operating Revenues	\$ 18,899	\$ 685	\$ 19,584
Operating Expenses	36,947	(10,116)	26,831
Operating Income (Loss)	<u>\$(18,048)</u>	<u>\$ 10,801</u>	<u>\$ (7,247)</u>
Interest Expense	5,429	(2,232)	3,197
Net Income (Loss)	<u><u>\$(23,477)</u></u>	<u><u>\$ 13,033</u></u>	<u><u>\$ (10,444)</u></u>

REVENUE REQUIREMENTS

The Commission has used the operating ratio method as the basis in determining sewer rates in the past and has found it to be a fair, just and reasonable method to both the utility and its customers. The Commission is of the opinion that a ratio of 88 percent is a fair, just and reasonable operating ratio in that it will enable Tree-Line Estates to pay its operating expenses and provide an adequate debt service coverage with a reasonable return

¹⁴ Ibid., Item 6.

to the plant's owner. Therefore, the Commission finds that Tree-Line Estates is entitled to adjust its rates to produce total revenues of \$34,719 which includes federal, state and Jefferson County income taxes of \$1,032 and interest expense of \$3,197. This results in an annual increase in revenue to Tree-Line Estates of \$15,135.

SUMMARY

On January 15, 1985, Tree-Line Estates submitted notice to the Commission of its intent to begin charging the rates advertised in its original application as of February 6, 1985. In its Order of February 5, 1985, the Commission ordered Tree-Line Estates to maintain its records in such manner as would enable it, or the Commission, or any of its customers, to determine the amounts to be refunded and to whom due in the event a refund is ordered upon final determination of this case in accordance with 807 KAR 5:076, Section 8. The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that:

1. The rates proposed by Tree-Line Estates would produce revenues in excess of those found reasonable herein and should be denied upon application of KRS 278.030.

2. The rates in Appendix A should produce gross annual revenue of approximately \$34,719 and are the fair, just and reasonable rates for Tree-Line Estates to charge for sewer service rendered on and after the date of this Order.

3. The rates charged by Tree-Line Estates on and after February 6, 1985, are in excess of the rates approved herein, and therefore, the difference should be refunded to the appropriate customers.

IT IS THEREFORE ORDERED that the rates proposed by Tree-Line Estates be and they hereby are denied.

IT IS FURTHER ORDERED that the revenues collected by Tree-Line Estates subsequent to February 6, 1985, through rates in excess of those found reasonable herein shall be refunded in the first billing after the date of this Order.

IT IS FURTHER ORDERED that Tree-Line Estates shall file a statement within 30 days of the date of this Order reflecting the number of customers billed, the amount collected under the rates put into effect on February 6, 1985, the number of customers receiving a refund, the amount refunded and the date of the refund.

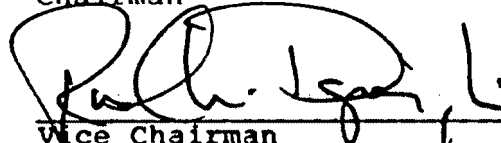
IT IS FURTHER ORDERED that the rates in Appendix A are the fair, just and reasonable rates to be charged by Tree-Line Estates for sewage service rendered on and after the date of this Order.

IT IS FURTHER ORDERED that, within 30 days of the date of this Order, Tree-Line Estates shall file with this Commission its tariff sheets setting forth the rates approved herein.

Done at Frankfort, Kentucky, this 26th day of April, 1985.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 9100 DATED 4/26/85

The following rates and charges are prescribed for the customers in the area served by Tree-Line Utilities, Inc., d/b/a Tree-Line Estates Sewage Treatment Plant located in Jefferson County, Kentucky. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

<u>RATES:</u>	Monthly
Single Family Residential	\$ 16.85
Multi - Family	13.30

APPENDIX B
4/26/85

Item & Invoice No.	Date	Amount	Estimated Life	Depreciation
New compressor for control system. #503-3	-	\$ 336	10 yrs.	\$ 34
Pumped down lagoon and stopped leaks. #304-11	1-28-83	\$1,018	5 yrs.	\$ 203
Installed pressure switch on old sump pump. Ran wires to lagoon to hook-up sump pump to pump out lagoon. #402-12	3-02-83	\$ 205	5 yrs.	\$ 41
Replaced compressor motor in lift station. #402-12	3-14-83	\$ 165	15 yrs.	\$ 11
Pumped out heavy sludge from the final tank and contact tank. Spread lime on sludge that had spilled during pump failures. #402-12	3-16-83	\$ 289	5 yrs.	\$ 58
Removed variable speed pump and replaced shaft and sleeve. Also, replaced mechanical seals, oil seals and bearings. Built up pump impeller with molecular metal compound. #613-9	5-3-83	\$ 624	15 yrs.	\$ 41
Cleaned and drained compressor and pressure switches. By-passed faulty overload relay in lift station. Return to install back-up air compressor and replaced overload. Flushed out load cell, added distilled water and recharged. #613-9	5-13-83	\$ 514	15 yrs.	\$ 34
Brought comminutor to shop and replaced burned out motor. Reinstalled comminutor at plant. #720-5	5-19-83	\$ 412	15 yrs.	\$ 27

Reconditioned used blower
and installed it on the
concrete base at the lagoon.
#1024-4

6-15-83 \$ 951 15 yrs. \$ 63

Pulled out blower and took
it to Republic Welding to
replace shaft. #1231-22

9-29-83 \$ 139 5 yrs. \$ 28

Installed new flap valve in
variable speed pump, unable
to draw vacuum. Pulled pump
and brought to shop.
#1231-22

10-11-83 \$ 288 5 yrs. \$ 57