

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF SARGENT AND)
STURGEON BUILDERS, INC., GARDEN-)
SIDE SUBDIVISION SEWER DIVISION,) CASE NO. 9127
FOR A RATE ADJUSTMENT PURSUANT)
TO THE ALTERNATIVE RATE FILING)
FOR SMALL UTILITIES)

O R D E R

On September 10, 1984, Sargent and Sturgeon Builders, Inc., ("Sargent and Sturgeon") Gardenside Subdivision Sewer Division ("Gardenside"), filed an application with the Commission to increase its sewer rate pursuant to 807 KAR 5:076, Alternative Rate Adjustment Procedure for Small Utilities ("ARF"). 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.

Gardenside's proposed rates would produce additional revenue of approximately \$8,456 annually, an increase of 28.5 percent over test-period actual operating revenues of \$29,659. Based on the findings herein, the Commission has determined that no

deficiency exists in the revenues of Gardenside and, therefore, no increase in revenues has been allowed.

A hearing was not requested in this matter, and in accordance with the provisions of the ARF, no hearing was conducted. The decision of the Commission is based on information contained in the application, written submissions, annual reports and other documents on file in the Commission's offices.

COMMENTARY

Gardenside is a privately-owned sewage treatment plant and serves approximately 231 residential customers in Daviess County, Kentucky. Gardenside is owned and operated by Sargent and Sturgeon, a corporation engaged in the business of developing and managing subdivisions, including the management and operation of the subdivisions' sewage treatment facilities. Sargent and Sturgeon also owns and operates Garden Heights Subdivision Sewer Division ("Garden Heights"). Due to this affiliation between Gardenside and Garden Heights, the divisions share resources such as labor, management, vehicles, etc.

Concurrent with the filing of this application, Sargent and Sturgeon filed Case No. 9128, The Application of Sargent and Sturgeon Builders, Inc., Garden Heights Subdivision Sewer Division, for a Rate Adjustment Pursuant to the Alternative Rate Filing for Small Utilities. Case No. 9128 has been closely coordinated with this proceeding.

Because Gardenside and Garden Heights are mutually-owned companies and share resources, several expenses incurred by Sargent and Sturgeon are related to both sewer divisions and have,

therefore, been allocated between the two divisions. Also Sargent and Sturgeon ceased its operations as a builder in the summer of 1983 according to information filed in its application. Therefore certain expenses previously absorbed by the building division have been allocated by Sargent and Sturgeon to the sewer divisions. For the most part, the expenses have been allocated based on the number of customers served by each sewer division. This results in an allocation of two-thirds to Gardenside which has 231 customers and one-third to Garden Heights which has 115 customers.

TEST PERIOD

The Commission has adopted the 12-month period ended December 31, 1983, as the test period for determining the reasonableness of the proposed rates. In utilizing the historical test period, the Commission has given full consideration to known and measurable changes found reasonable.

REVENUES AND EXPENSES

For the test period Gardenside reported a net operating loss from sewage operations of \$3,593. Gardenside proposed several pro forma adjustments to revenues and expenses to reflect more current and anticipated operating conditions. The Commission is of the opinion that the proposed adjustments are generally proper and acceptable for rate-making purposes with the following modifications:

Revenue Normalization

Gardenside reported test-year operating revenues of \$29,659. In order to normalize annual operating revenues, the Commission has adjusted reported test-year operating revenues by

\$445 to \$30,104 based on the number of customers and the monthly rate at the end of the test year.

Management Fee

Gardenside proposed an adjustment of \$1,950 to the test period salary of \$5,850 for Mr. T. L. Sargent, president of Gardenside. In cases involving like-sized sewer utilities with comparable organizational structures, the Commission has normally allowed owner/managers an annual fee of \$1,800. Additional compensation above that level must be sufficiently documented and justified.

In its information request of December 19, 1984, the Commission requested Gardenside to provide any evidence as to why a manager's fee higher than \$1,800 should be allowed in this case. In response to that request, Gardenside stated that,

Mr. Sargent expends a great amount of time in the management of this treatment plant and its operations, and in addition has been kind enough to make loans to the corporation to allow the continued operations of the treatment plants pending the receipt of a rate increase, since the treatment plant produces a cash flow considerably less than what is required to pay its expenses. Mr. Sargent has made loans to the corporation in the amount of \$5,000.00 on April 28, 1982, and \$4,200.42 on October 5, 1984, neither of which loans have been repaid.

Whether Mr. Sargent has or has not made loans to Gardenside has no bearing on the appropriate level of compensation which should be allowed for rate-making purposes in this proceeding. Also, if Mr. Sargent is seeking a return on his investment through his management fee, the Commission cannot provide such a return in

this fee as well as through the provision of a reasonable rate of return.

In its information request of October 12, 1984, the Commission requested Gardenside to provide the total number of regular and overtime hours worked during the test year as well as a complete description of the duties and responsibilities of each employee, manager or owner.

In regard to Mr. Sargent, Gardenside stated in its response to the Commission's request that,

T. L. Sargent is on call 24 hours per day, handles customers complaints, if any, all record keeping, banking, and office management. He further checks the plants a minimum of one time per week and oversees the performance by John Lewis of the daily maintenance, repair and operation of the treatment plants.

In this proceeding, Gardenside has proposed a monthly expense of \$133 for an accountant. The cost for accounting services has been included in this case and the Commission finds that since Gardenside will employ an accountant for record keeping Mr. Sargent should not be allowed compensation for this function as well. It is the Commission's opinion that Gardenside has failed to meet its burden of proof as to why a higher than normal management salary should be allowed in this instance. Therefore, the Commission has allowed a management fee of \$1,800, which includes a provision for incidental travel expense, for rate-making purposes.

Salaries Expense

Gardenside reported a test-year salary expense for Mr. John Lewis of \$11,895. Mr. Lewis performs all maintenance and repair

duties at the treatment plant. The salary expense of \$11,895 is based upon an allocation of 75 percent of Mr. Lewis' total annual salary to Gardenside.

Since Gardenside has proposed to allocate various other expenses on the basis of two-thirds to Gardenside and one-third to Garden Heights, the Commission is of the opinion that Gardenside should be consistent and allocate two-thirds of Mr. Lewis' salary to Gardenside.

Mr. Lewis' salary is based on two trips daily to the sewage treatment plant. In Gardenside's last rate proceeding, Case No. 8238, The Adjustment of Rates of the Sargent and Sturgeon Builders, Inc., dated October 28, 1981, the Commission found that "once-a-day inspections should provide for sufficient maintenance of the treatment plant" and that "twice daily inspections are not essential to an efficient operation and should not be allowed for rate-making purposes."

The Commission, in its information request of December 19, 1984, requested Gardenside to "provide any evidence deemed appropriate as to why the Commission should allow the expense associated with twice-daily inspections in this proceeding." Gardenside responded by stating that,

The sewage treatment plant will become septic in a period of eight hours in the event that there is a failure or a breakdown in any electrical or mechanical equipment. . . . An inspection schedule of less than two trips per day at 10 or 12 hour intervals would create a 23 hour period during which there would be no discovery of a malfunction. . . . If the plant is shut down for the possible 23 hours [between trips]. . . it would take from three to four days for the effluent to reach the level which is apparently acceptable to the Department of Health

and the Environmental Protection Agency. . .[and would result in] a condition which would adversely affect the health and welfare of the customers. . . [and] create an unhealthy and unpleasant atmosphere in the subdivision.¹

The argument presented by Gardenside is true for almost all sewer utilities. This is why the Commission provides, in most instances, for daily trips to the plant when establishing a reasonable cost of utility service. A successful maintenance program should reduce the risk of equipment failure to a very slight possibility. Of course, twice daily trips are desirable, three would be better, and, ideally, a maintenance man could be stationed at the plant 24 hours a day. However, in determining a reasonable number of trips, the costs to the customers must be weighed against the benefits.

In its information request of October 12, 1984, the Commission requested Gardenside to provide the total number of regular and over-time hours worked during the test year as well as a complete description of the duties and responsibilities of each employee, manager, or owner.

In regard to Mr. Lewis, Gardenside stated in its response to the Commission's request that,

John Lewis works six hours per day, three in the morning and three in the evening, seven days per week, and is on call 24 hours per day. He checks the plant two times daily, performs all maintenance and repairs for which he is qualified, tests the effluent, and performs such other duties as required by Mr. Sargent.

¹ Response, Commission's Information Request of December 19, 1984, Item 15.

In this proceeding, as evidenced by Gardenside's response, the extra trip is to determine whether or not a malfunction of equipment has occurred. No evidence has been provided that there have been frequent equipment failures at the plant, or that there might be. As no persuasive evidence has been presented in this case to justify the additional daily trip, the Commission finds that Gardenside has not met its burden of proof on the necessity of twice daily trips in this case. Additionally, other means to alert sewer plant owners of equipment failure may be a reasonable alternative to personal inspections.

Allocating two-thirds of Mr. Lewis' total annual salary of \$15,860 to Gardenside, then eliminating one-half of that for the second daily trip found to be unnecessary, results in an allowance, for rate-making purposes, of \$5,287 for salaries expense.

Travel Expense

Gardenside reported test-year travel expense of \$2,085. This expense is based upon annual mileage of 21,900 for Mr. Lewis and 3,120 for Mr. Sargent. These mileage figures do not represent actual documented mileage, but rather are estimates provided by Gardenside.

In its information request of December 19, 1984, the Commission requested Gardenside to provide the basis for using \$.25 as the reimbursement rate per mile, the actual miles traveled during the test year with documentation included, the basis for the mileage figures used in the calculation of car and truck

expense, and a narrative explanation of the daily route traveled by Mr. Lewis.

In response to that request, Gardenside stated that,

The use of \$.25 per mile as the reimbursement rate for travel is based upon the prior years actual costs of vehicle operations, as calculated by the accountants. The actual mileage for a round trip between sewage treatment plants is 30 miles, as calculated by Mr. Sargent and Mr. Lewis. We know of no manner in which this can be further documented.²

Other than the fact that Gardenside used \$.25 per mile as the reimbursement rate for the test year, no persuasive justification was presented in support of this rate. The current tax standard mileage rate prescribed by the Internal Revenue Code, Section 162, is \$.205 per mile. It is the Commission's opinion that \$.205 per mile is a fair, just and reasonable reimbursement rate for transportation and it has therefore utilized this amount as the basis for determining transportation expense herein.

The \$1,800 management fee normally allowed for like-sized sewer utilities is considered to be sufficient compensation for the owner/manager including his incidental travel expense. Therefore, the Commission has disallowed the test year transportation expense applicable to Mr. Sargent.

As stated in the previous section on salaries expense, the Commission finds that one trip daily to the plant is sufficient. Mr. Lewis' annual mileage of 21,900 reflects two trips daily and also is his total mileage for both Gardenside and Garden Heights.

² Response to Commission's Request of December 19, 1984.

Reducing his mileage by one-half to reflect the exclusion of the second daily trip, then applying the rate of 20.5 cents per mile, and finally allocating one-half of that product to Gardenside as was done in regard to travel expense in Gardenside's last rate case results in an adjusted travel expense of \$1,122 for rate-making purposes.

The Internal Revenue Code, Section 274(d), as amended by the Tax Reform Act of 1984 requires taxpayers to keep adequate contemporaneous records to substantiate transportation expense. In regard to future rate cases, the Commission will not allow Gardenside a transportation expense without adequate contemporaneous records substantiating actual transportation expense for the test year. Therefore, the Commission recommends that Gardenside keep records of actual mileage and actual expenses incurred in the operation of a motor vehicle while on official utility business.

Taxes Other Than Income Tax Expense

Gardenside proposed an adjustment of \$354 to Account No. 408.1--Taxes Other Than Income Taxes. This was based upon a proposed adjustment of \$1,950 to the test year salary of Mr. Sargent. However, the proposed adjustment was not only disallowed, but Mr. Sargent's allowed management fee, for rate-making purposes, was reduced to \$1,800. Furthermore, the salary for Mr. Lewis was reduced to \$5,287 to reflect the elimination of one-half of his salary applicable to the second daily trip to the treatment plant. Based upon current state and federal unemployment tax rates and the current FICA tax rate for employers, as well as

reported test year property and ad valorem taxes, the Commission finds that Gardenside should be allowed, for rate-making purposes, an adjusted taxes other than income tax expense of \$1,838.

Other Expenses

Gardenside proposed an adjustment of \$603 to Account No. 700-B--Other Expenses. In the Commission's information request of December 19, 1984, Gardenside was asked to provide the calculation of the proposed adjustment and any documentation to support the adjustment. In its response to that information request, Gardenside stated that \$603 "is the amount of hazard insurance, including public liability, which is allocated to this sewer division." Gardenside provided no documentation to support the proposed adjustment and the Commission finds that Gardenside has not provided sufficient evidence that the \$603 is or will be a valid expense of the utility. Therefore, the proposed adjustment has been excluded for rate-making purposes herein.

In response to the Commission's information request of December 19, 1984, regarding the purchase of water meters in the amount of \$514, Gardenside stated that "this amount was included as an expense in the annual report by error." Therefore, Account No. 700-B--Other Expenses has been reduced by \$514 to exclude this cost. The preceding adjustments result in adjusted Other Expenses of \$1,478 for rate-making purposes herein.

Sludge Hauling Expense

Gardenside reported test-year sludge hauling expense of \$850. In its response to the Commission's information request of October 12, 1984, Gardenside filed copies of invoices for sludge

hauling for the test year in the amount of \$495. Since Gardenside did not provide any documentation for the additional \$355 of reported test-year sludge hauling expense, the Commission cannot include the total reported expense for rate-making purposes. Therefore, the Commission has reduced sludge hauling expense by \$355 which results in adjusted expense of \$495 for rate-making purposes.

Water Expense

Gardenside proposed an adjustment of \$94 to reflect test-year level of water expense. No water expense was reported for the test year, but Gardenside stated that this cost had been absorbed in the past by the construction element of Sargent and Sturgeon, which has now ceased operations.

In response to the Commission's information request of October 12, 1984, Gardenside filed copies of water bills for the test year in the amount of \$84. It is apparent from the bills supplied that this was a valid expense of Gardenside. Since Gardenside did not provide documentation for the additional \$10 of the proposed adjustment, the Commission has allowed an adjustment of \$84 to water expense for rate-making purposes herein.

Electricity Expense

Gardenside reported test-year electricity expense of \$2,997 and proposed an adjustment of \$2,976 based on advice from representatives of their supplier, Green River Electric Corporation ("GREC"), that it is anticipated that the rates charged for electricity will increase 15 percent over the next 2-year period. Whereas the Commission does currently have pending before it an

application by GREC to flow through a proposed wholesale rate by its supplier, Big Rivers Electric Corporation, that proceeding has yet to be resolved and any adjustment made in anticipation of its outcome would be arbitrary and speculative. As the result of that case is not a known and measurable event, the Commission will not allow Gardenside's proposed adjustment for rate-making purposes.

In order to document actual test-year electricity expense, the Commission requested copies of the 1983 electricity bills. Based on its review of these bills the Commission has determined that \$4,383 was the actual test-year electricity expense of Gardenside and has used that amount for rate-making purposes herein.

Rate Case Expense

The ARF procedure was established to provide a simplified and less expensive method for small utilities to present cases before the Commission. The ARF application was designed so that the utility should encounter little or no difficulty in presenting its case for an increase in rates. In most instances no legal assistance is necessary. The type of information requested by the Commission in its information requests of October 12 and December 19, 1984, should have been readily available in the offices of Gardenside and the services of an attorney should not have been required in obtaining this information.

It is the opinion of the Commission that a minimal amount of rate case expense should be incurred by a utility under the ARF

procedure. In this case, Gardenside provided a statement for \$4,200 from its attorney for rate case charges through November 6, 1984. Two-thirds of this amount was to be allocated to Gardenside and one-third to Garden Heights. In addition to the \$2,800 mentioned above to be allocated to Gardenside, Gardenside's attorney stated that \$200 in out-of-pocket expenses had been incurred. Furthermore, \$400 in accounting fees had been charged to Gardenside in connection with this rate case. Thus, Gardenside proposed a total rate case expense of \$3,400 to be amortized over 2 years.

The Commission finds that Gardenside has not provided sufficient justification for the inclusion of more than \$1,000 in rate case expenses in this proceeding. Furthermore, Gardenside has provided no persuasive evidence as to why the Commission should deviate from past practice concerning the 3-year amortization period which has generally been utilized in proceedings of this kind. Therefore, the Commission has allowed, for rate-making purposes, rate case expense of \$333.

After consideration of the aforementioned adjustments, the Commission finds Gardenside's adjusted test period operations to be as follows:

	<u>Actual Test Period</u>	<u>Pro Forma Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$29,659	\$ 445	\$30,104
Operating Expenses	33,252	<10,306>	22,946
Operating/Net Income	<u>\$<3,593></u>	<u>\$ 10,751</u>	<u>\$ 7,158</u>

REVENUE REQUIREMENTS

The Commission is of the opinion that the operating ratio³ is a fair, just and reasonable method for determining revenue requirements in this case and finds that an operating ratio of 88 percent will allow Gardenside to pay its operating expenses and provide a reasonable return to its owners.

In this case, the use of an 88 percent after-tax operating ratio applied to the adjusted test-year operating expenses results in a revenue requirement of \$26,965 which is less than the actual test period revenues. Therefore, the Commission finds that no deficiency exists in the revenues of Gardenside and has, therefore, allowed no increase in revenues.

SUMMARY

The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that the rate proposed by Gardenside should be denied.

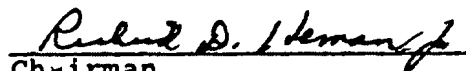
IT IS THEREFORE ORDERED that the proposed rate in Gardenside's application be and it hereby is denied.

IT IS FURTHER ORDERED that the rate currently charged by Gardenside shall remain in effect.

³ Operating Ratio = $\frac{\text{Operating Expenses}}{\text{Gross Revenue}}$

Done at Frankfort, Kentucky, this 25th day of March, 1985.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary