

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

STONEBROOK SANITATION COMPANY, INC.)
FOR AN ADJUSTMENT OF RATES PURSUANT) CASE NO. 9135
TO THE ALTERNATIVE PROCEDURE FOR)
SMALL UTILITIES)

O R D E R

On September 10, 1984, Stonebrook Sanitation Company ("Stonebrook") 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.

On October 16, 1984, Farmgate Homeowners' Association ("Farmgate") requested full intervention in this case, which was granted November 2, 1984. On January 21, 1985, Farmgate requested that the Commission schedule a hearing in this matter. A hearing was subsequently held on March 7, 1985, at the Commission's offices in Frankfort, Kentucky.

Stonebrook requested a rate which would produce an annual increase of \$21,563 based on adjusted test period operating

revenues per rate changes in Case No. 8770.¹ In this Order, the Commission has allowed a rate which will produce an annual increase of \$11,911.

On March 27, 1985, Farmgate filed its brief in the case. All information requested by the Commission and the intervenor has been submitted for consideration in this matter.

In its application, Stonebrook proposed adjustments to fuel and water expenses based on general increases in these services. In the past, the Commission staff has often recalculated these adjustments at a considerable expense of time based on actual charges for specific types of services rendered. In this case, the Commission requested that Stonebrook prepare supporting documentation of its proposed fuel and water adjustments. Stonebrook subsequently provided the staff with detailed worksheets in support of these two adjustments. The Commission commends Stonebrook in preparing adequate support for these adjustments and looks forward to such cooperation in the future.

MOTIONS AT THE HEARING

At the hearing on March 7, 1985, a motion to dismiss Stonebrook's application was presented by Mr. Carl J. Bensinger, counsel for Farmgate, on the grounds that Stonebrook did not meet

¹ "Application of Stonebrook Sanitation Company, Inc. for Consideration of a Rate Adjustment and a Certificate of Convenience and Necessity to Construct Improvements to Existing Facilities and Authority to Borrow Funds Necessary for Such Purposes, Order dated November 3, 1983, and amended on May 8, 1984."

the filing requirements for a small utility and that the application was untimely and unduly burdensome on the ratepayers and on Farmgate, causing the necessity of intervention so soon after the prior rate case. A similar motion was submitted by Mr. Bensinger on October 16, 1984, and was denied by the Commission² because the reasons given by Farmgate were insufficient and spurious. The Commission is of the opinion that this present motion should also be denied on the same grounds.

All other motions or objections that were not decided upon at the time of the hearing are hereby denied.

TEST PERIOD

Stonebrook has proposed and the Commission has accepted the 12-month period ending December 31, 1983, as the test period in this matter.

REVENUE AND EXPENSES

Based on rates approved in Case No. 8770 Stonebrook incurred a net operating loss of \$7,331 for the test period. Stonebrook proposed numerous adjustments to expenses in order to reflect more current operating conditions which results in a net operating loss of \$5,402. The Commission has accepted Stonebrook's pro forma revenues and expenses with the following exceptions:

Fuel Expense

Stonebrook proposed a pro forma fuel cost of \$15,699 based on a 7-1/2 percent increase from the Louisville Gas and Electric

2 Order dated November 2, 1984.

Company. Stonebrook provided the Commission a worksheet in response to its second request in which it showed a revised pro forma fuel cost of \$14,535, based on actual test period usage and the current rates.³

In the same response, Stonebrook informed the Commission that a second 25 horsepower blower had to be operated most of the time during the final quarter of 1984 and that the blower was expected to be operated full-time in the future. At the hearing Mr. Carroll F. Cogan, Owner and Manager of Stonebrook, estimated the cost to operate the additional blower to be approximately \$289 per month or \$3,396 on an annual basis.⁴ After reviewing the estimate provided by Mr. Cogan, the Commission is of the opinion that it is appropriate and therefore has adjusted Stonebrook's proposed level of expense of \$14,535 by the \$3,396. This results in an adjusted level of \$17,931.

Water Cost

Stonebrook proposed a pro forma water expense of \$2,116 due to a rate increase by the Louisville Water Company. This adjustment was later amended to \$2,320 by Stonebrook. In reviewing the worksheet provided in response to the second Commission request, it was noted that Stonebrook had used the rates for the wrong sized water meter in its calculations. Therefore, using the correct rates, the Commission has determined

³ Response to Commission's request of January 28, 1985, filed February 7, 1985.

⁴ Transcript of Evidence ("T.E.") dated March 7, 1985, page 109.

the adjusted level of this expense to be \$2,403, an increase to Stonebrook's pro forma expense of \$83.

Maintenance of Treatment and Disposal Plant

Stonebrook incurred maintenance of treatment and disposal plant of \$3,729 for the test period. The Commission has reviewed the invoices submitted by Stonebrook to substantiate these expenses and has discovered that Invoice No. 218-14 along with the Invoice to Resco Rents in the amounts of \$309⁵ and \$40, respectively, were for work completed prior to the test period. Therefore the Commission has removed these expenditures from the test period expenses. A credit-memo for Invoice No. 811-2 in the amount of \$507 is also for work completed prior to the test period and therefore the Commission has also increased test period expenses by this amount.

In addition, the Commission has determined that the expenses related to the repair of a blower should properly have been capitalized as they will benefit not only the current period, but future periods. A breakdown of these expenses is as follows:

<u>Item & Invoice No.</u>	<u>Date</u>	<u>Amount</u>
Removal of blower # 218-14	2-18-83	\$ 210
Repair of blower # 307-1	3-07-83	\$1,070
Installation of blower #328-6	3-28-83	102

⁵ Excluding the cost of removing the blower of \$210 which will be discussed later.

The Commission is of the opinion that these items totaling \$1,382 should have been capitalized and depreciated over 3 years. Mr. Cogan concurred at the hearing that these expenses should have been capitalized and amortized over 2 or 3 years.⁶ Therefore, maintenance expense has been reduced by \$1,224 and depreciation increased by \$461 for a net reduction in test period operating expenses of \$763.

Outside Services

Stonebrook recorded outside services of \$1,996 for the test period. In the response to the first Commission request, Stonebrook supplied an invoice from Citizens Fidelity Bank in the amount of \$315 for an escrow account.⁷ The invoice was mainly for services rendered prior to the test period. At the hearing, Mr. Cogan agreed that this invoice probably included costs outside the test period, but that Stonebrook was still incurring a yearly cost to maintain this account.⁸ In information supplied after the hearing, Stonebrook estimated that the yearly cost of the escrow account is \$120. Therefore, the Commission has decreased this expense by \$195 to reflect the yearly cost of the escrow account.

The Commission in a further review of the invoices discovered that Stonebrook had included the cost of customer notification from Case No. 8770 in the amount of \$163. The

⁶ T. E., page 71.

⁷ Response to Commission's request of November 13, 1984, filed December 26, 1984.

⁸ T. E., pages 66.

Commission is of the opinion that this expense should have been amortized over 3 years similar to other associated rate case expenses. Therefore, the Commission has reduced outside services by \$163 and increased the amortization expense by \$54 for a net reduction in test period operating expense of \$304.

Transportation Expense

Stonebrook incurred transportation expense of \$958 for the test period. In response to the first Commission request, Stonebrook provided an undated invoice from Carroll Cogan Companies, Inc., ("CCC") in the amount of \$768, which was \$190 less than the amount recorded on the books of Stonebrook. The documentation on the invoice reflected six trips to Frankfort at 25 cents per mile and two trips to the Jefferson County Health Department, 2 trips to the attorney's and accountant's offices and 12 trips to the plant at \$35 per trip. In response to the second Commission request and later at the hearing, Mr. Cogan testified that the \$35 minimum charge was based on time rates rather than mileage and was developed for situations where a vehicle is required for up to 8 hours while the mileage used might be minimal.

Because CCC and Stonebrook are mutually-owned companies, it is the Commission's opinion that the transaction for car rental between CCC and Stonebrook is a less-than-arms-length transaction. Therefore, the burden of proof is on Stonebrook to establish justification and a sound basis for the expense. Moreover, reasonable expenses have been allowed in this case for outside service companies to maintain the plant on a routine and

non-routine basis. Substantially all transportation to and from Stonebrook for routine maintenance, sludge hauling and non-routine maintenance is provided for either within a monthly fee or billed by vendors on a per-mile basis. No basis as to the necessity or purpose of the additional travel by Mr. Cogan has been provided; and therefore the expense should be disallowed.

Furthermore, it is the Commission's opinion that the cost of travel by Mr. Cogan for trips to the Stonebrook plant site is included as a part of the monthly fee paid to Andriot-Davidson's Service Co., Inc., ("Andriot-Davidson") for routine maintenance. Mr. Cogan is an employee of Andriot-Davidson and visits by him to the plant site are properly construed as travel by him in his capacity as a representative of Andriot-Davidson providing routine maintenance. Since the contract for routine maintenance between Stonebrook and Andriot-Davidson makes no provision for additional payments for travel, the charges for transportation are inappropriate.

It is the Commission's policy to allow managers of sewer utilities of the size of Stonebrook annual compensation of \$1,800, including travel. Therefore, it is the Commission's finding that Stonebrook has not met its burden of proof on this issue and the Commission has, therefore, eliminated reported test-year transportation expense of \$768 from operating expenses for rate-making purposes.

Miscellaneous General Expenses

During the test period Stonebrook incurred finance charges of \$2,071 from Andriot-Davidson and service charges of \$140 from

Kentucky Sewer Service. Both charges were incorrectly reported in Account No. 930-Miscellaneous General Expenses. The proper classification for the finance charge from Andriot-Davidson is Account 430-Interest on Debt to Associated Companies while the service charge from the Kentucky Sewer Service should be classified in Account No. 431-Other Interest Expense. The Commission's findings with this regard are further discussed later in this Order.

Interest Expense on Long-Term Debt

Stonebrook proposed a pro forma test period interest expense on long-term debt of \$6,283, which included interest expense of \$2,233 based on the mortgage note to South East Federal. This debt was incurred by Stonebrook's previous owners and was made a part of the transfer agreement with Mr. Cogan in Case No. 8676.⁹ At the hearing Mr. Cogan testified that the note to South East Federal was paid in full in December 1984 and is no longer an obligation to Stonebrook.¹⁰ Therefore, the Commission has removed this interest expense from the test period expenses.

In the original application, Stonebrook proposed a pro forma adjustment of \$4,050 to test period interest expense on long-term debt of \$30,000 from Citizens Fidelity at an interest

⁹ "An Investigation of the Transfer of Ownership and Control of Stonebrook Sanitation Company, Inc."

¹⁰ T.E., page 71.

rate of 13.5 percent.¹¹ In Case No. 8770, the Commission recognized that Stonebrook would be required to borrow funds for the repairs made to the original concrete plant in the amount of \$24,070. Mr. Cogan testified at the hearing that the difference between the actual loan and the amount recognized for the actual costs of the repairs in the prior case could be attributed to the payment of past due operating expenses, ie., electric bills.¹² In Case No. 8770, Stonebrook was given the opportunity to request a rehearing on its financing issue subject to documented proof of said financing. Stonebrook filed an untimely request for rehearing on January 16, 1984. Therefore, the issue of financing was not reviewed on rehearing.

In a further attempt to obtain financing for this construction, Stonebrook filed Case No. 9088.¹³ The Attorney General's Office moved that the case be dismissed for lack of meeting the requirements of appropriate statutes and the general lack of evidence. On July 31, this case was dismissed.

Although Stonebrook has not explicitly requested the approval of financing for the repairs made to its old treatment plant in this case, the evidence of record in Case Nos. 8770 and

¹¹ The interest rate is based on 1 percent over prime at the filing date.

¹² T.E., page 48.

¹³ "Application of Stonebrook Sanitation Co., Inc., for Approval of Borrowing of Funds to Finance Improvements and Approve Change in Depreciation Allowance on Said Improvements and Increase in Rates to Support Changes."

9088 provides adequate support for approval of such financing at this time.

It is the Commission's opinion that Stonebrook's inability to remain current in its operating expenses and the deterioration of Stonebrook's financial position is due to Stonebrook's failure to request rate relief in the past. Stonebrook's last rate increase prior to 1983 in Case No. 8770 was in December of 1979. Stonebrook's failure to request rate relief earlier is a material reason why Stonebrook needed the additional funds from its note to Citizens Fidelity. The burden to obtain revenues sufficient to cover current operating expenses rests with the management of Stonebrook, and its failure to seek sufficient revenues in the past does not justify recovering those past expenses from the present ratepayers. To allow Stonebrook to recover these costs would constitute retroactive rate-making.

The Commission, therefore, has allowed for rate-making purposes interest on the long term debt approved herein in the amount of \$24,070 at an interest rate of 11.5 percent.¹⁴ This results in a test period interest expense of \$2,768.

Stonebrook revised its pro forma adjusted interest expense on long-term debt to include interest expense of \$5,000 from the stock purchase agreement made with the original owners. In Stonebrook's transfer case, Case No. 8676, the Commission approved the transfer of ownership, but did not approve the financing

¹⁴ Response to the Commission's request of January 18, 1985, filed February 7, 1985, Item 7b.

specifically identified in the stock purchase agreement. In Case No. 8770, the Commission instructed Stonebrook to file a motion and all related evidence to either reopen Case No. 8676 or to file an application for financing consistent with the Commission's regulations with regard to its stock purchase agreement in that case. At this time, neither has been done.

The Commission finds as it did in Case No. 9104¹⁵ that if the financing for the stock purchase agreement were approved, it would be forcing the ratepayers to bear the cost of financing the assets that are already owned by Stonebrook. The assets were originally purchased by Stonebrook with the note to South East Federal which was fully paid in December of 1984.

Therefore, the Commission has disallowed the inclusion of this interest expense on the unauthorized financing of the stock purchase agreement and has allowed for rate-making purposes a pro forma interest on long-term debt of \$2,768, a reduction of \$8,515 from Stonebrook's proposed level.

The Commission reiterates its position taken in Case No. 8770 that Stonebrook should request to reopen Case No. 8676 or file a new case requesting approval of the financing of the stock purchase agreement.

Short Term Interest Expense

Stonebrook incurred interest on short term debt during the test period of \$2,860, composed of Andriot-Davidson interest

¹⁵ Case No. 9104, "An Adjustment of Rates of Cedar Creek Sewer Co., Inc., d/b/a Cedar Lake Park Sewer Company."

expense of \$2,071, interest to associated companies of \$150, service charges to Kentucky Sewer Service of \$140 and other interest expense of \$499 to Carroll Cogan Company Special Loan Account. In testimony at the hearing, Mr. Cogan testified that the loans from the associated companies were borrowed to pay current operating expenses and obligations.¹⁶ The Commission is of the opinion that this is similar to the money borrowed from Citizens Fidelity to pay past due operating expenses. Therefore, the Commission has disallowed the interest expense from associated companies reflected in the test period operating expenses in the amount of \$649.

The finance charge of Andriot-Davidson is based upon 1-1/2 percent of the outstanding balance payable to Andriot-Davidson for routine maintenance and operating supplies. In its review of finance charges to Andriot-Davidson and Kentucky Sewer Service, the Commission takes note of its findings in other interest-related matters with regard to Stonebrook's lack of filing for timely rate relief during financially hard times. If the interest expense for these items were allowed at this time, it would constitute retroactive rate-making.

At the hearing Mr. Cogan testified that Stonebrook is attempting to reduce its debt to Andriot-Davidson as fast as available funds will allow. However, the Commission notes that the amount due Andriot-Davidson at the beginning of the year was \$8,947 while the amount due at the end of the year was \$10,395.

¹⁶ T.E., page 77.

Therefore, the Commission is not convinced that the service or finance charges were incurred prudently and for just cause. Thus, the Commission has disallowed these charges along with the previously mentioned interest from the operating expenses for rate-making purposes, a total reduction of \$2,860.

Insurance Expense

Stonebrook incurred insurance expenses of \$601 for the test period, which included \$176 for term life insurance premiums for Mr. Cogan. Information supplied by Stonebrook after the hearing contained evidence that Mr. Cogan's estate was the beneficiary of this policy, which was effected to ensure that stock purchase agreements are fulfilled. Since Mr. Cogan's estate is the beneficiary, Stonebrook has provided no evidence to indicate that the ratepayers received any material benefit from the policy and therefore the expense should not be borne by the ratepayers. Thus the Commission has reduced test period insurance expenses by \$176.

Taxes Other Than Income

Stonebrook reported taxes other than income taxes of \$1,887 for the test period. The Commission staff after reviewing the information Stonebrook supplied after the hearing found that Stonebrook had mistakenly accounted for in the test period property taxes of \$798 twice. Therefore, the Commission has reduced test period operating expenses by \$798.

Income Tax Expense

Stonebrook projected income tax expense of \$2,636 based upon the level of net income requested. After reviewing Stonebrook's 1981 tax return, it was noted that investment tax

credit of \$8,576 was available to Stonebrook and at the hearing this was also noted by the intervenors. Therefore, the Commission has determined federal, state and Jefferson County income taxes of \$1,328, an adjustment of \$1,308. Federal tax includes investment tax credits amortized over the life of the asset to which the investment tax was advised.¹⁷ Therefore, the adjusted operations of Stonebrook are stated as follows:

	<u>Stonebrook Revised Adjusted</u>	<u>Commission Adjustments</u>	<u>Commission Adjusted</u>
Operating Revenues	\$ 53,760	\$ -0-	\$ 53,760
Operating Expenses	58,202	<2,849>	55,353
Net Operating Income	<u>\$ <4,442></u>	<u>\$ 2,849</u>	<u>\$ <1,593></u>
Interest Expense	<u>11,932</u>	<u><9,164></u>	<u>2,768</u>
Net Income (Loss)	<u><u>\$ <16,374></u></u>	<u><u>\$ 12,013</u></u>	<u><u>\$ < 4,361></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 Stonebrook to pay its operating expenses and provide an adequate debt service coverage with a reasonable return to the plant's owner. Therefore, the Commission finds that Stonebrook is entitled to adjust its rates to produce total revenues of \$65,671 which includes net federal, state and Jefferson County income

¹⁷ Federal Tax - Amortized Investment Tax Credit ("AITC") = Net Federal Tax = \$1,263 - \$390 = \$873
AITC = Investment Tax Credit ÷ 22 Average Life of Plant = \$8,571 ÷ 22 = \$390

taxes of \$1,328 and interest expense of \$2,768. This results in an annual increase in revenue to Stonebrook of \$11,911 over test period normalized revenue of \$53,760.

OTHER ISSUES

Depreciation Expense

In Case No. 8770 the Commission allowed Stonebrook to depreciate the repairs made to the concrete plant of \$24,070 over a 10-year life. Stonebrook has proposed that the Commission should reconsider its position and change the depreciable life from 10 to 5 years. Stonebrook bases its proposal on the fact that the repairs were made to used equipment and a 5-year life is more appropriate than 10 years since the equipment probably will not last more than 5 years without further major repairs being made. In reviewing the record in Case No. 8770, and the additional evidence provided in this case, the Commission is of the opinion that its original finding was correct and it is not persuaded to change the depreciable life in this instance. Therefore, the Commission has left the depreciable life of the repair to the concrete plant at 10 years.

Telephone Expense

The Commission has taken note that Mr. Cogan has chosen to allocate the telephone bills by month to his various utilities. Stonebrook has included in its test period expenses the full month of December. Although the Commission has made no adjustments in this instance it is of the opinion that a more appropriate method of allocating the telephone bills among the various utilities

exists, and advises Mr. Cogan to adopt a better methodology of allocating these costs.

SUMMARY

On January 14, 1985, Stonebrook submitted notice to the Commission of its intent to begin charging the rates advertised in its original application as of February 15, 1985. In a letter of the Commission dated February 11, 1985, the effective date was recognized to be March 2, 1985. In its Order of February 28, 1985, the Commission ordered Stonebrook 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 rate proposed by Stonebrook would produce revenues in excess of those found reasonable herein and should be denied upon application of KRS 278.030.

2. The rate in Appendix A should produce gross annual revenue of approximately \$65,671 and is the fair, just and reasonable rate for Stonebrook to charge for sewage service rendered on and after the date of this Order.

3. The rate charged by Stonebrook on and after March 2, 1985, is in excess of the rate approved herein, and therefore, the difference should be refunded to the appropriate customers.

4. The financing of the repairs made to the old concrete plant in the amount of \$24,070 by Stonebrook should be approved.

IT IS THEREFORE ORDERED that the rate proposed by Stonebrook be and it hereby is denied.

IT IS FURTHER ORDERED that the rate in Appendix A is the fair, just and reasonable rate to be charged by Stonebrook for sewage service rendered on and after the date of this Order.

IT IS FURTHER ORDERED that the revenues collected by Stonebrook subsequent to March 2, 1985, through a rate in excess of that found reasonable herein shall be refunded in the first billing after the date of this Order.


IT IS FURTHER ORDERED that Stonebrook shall file a statement within 30 days of the date of this Order reflecting the number of customers billed, the amount collected under the rate put into effect on March 2, 1985, the number of customers receiving a refund, the amount refunded and the date of the refund.

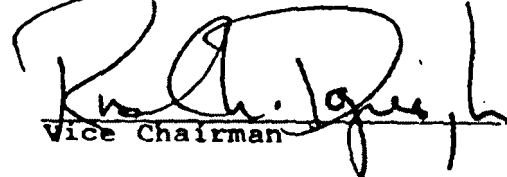
IT IS FURTHER ORDERED that the financing of the repairs made to the old concrete plant in the amount of \$24,070 be and it hereby is approved.

IT IS FURTHER ORDERED that, within 30 days of the date of this Order, Stonebrook shall file with this Commission its tariff sheets setting forth the rate approved herein.

Done at Frankfort, Kentucky, this 1st day of May, 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. 9130 DATED MAY 1, 1985

The following rates and charges are prescribed for the customers receiving service from Stonebrook Sanitation Company, Inc., d/b/a Farmgate Sewer System. 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>Customer Class</u>	<u>Rate</u>
Single Family	
Residential	\$ 13.72