

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

AN APPLICATION OF FERN CREEK)
SEWER COMPANY, INC., FOR AN) CASE NO. 9137
ADJUSTMENT OF RATES)

O R D E R

On September 12, 1984, Fern Creek Sewer Company, Inc., ("Fern Creek") filed its application with the Commission requesting to increase its rates for sewage treatment service pursuant to 807 KAR 5:076, the Alternative Rate Adjustment Procedure for Small Utilities ("ARF"). Fern Creek stated that the proposed rates would produce additional revenues of \$14,487 annually, an increase of 181.5 percent over test year revenues. Based on the determination herein, Fern Creek has been granted an increase in revenues of \$7,184, an increase of 90 percent.

COMMENTARY

In accordance with the provisions of the ARF regulation, no hearing was held in this matter. The Commission's decision is based on information contained in Fern Creek's application and annual reports, along with its responses to the Commission's written requests for information.

Fern Creek is a privately-owned corporation providing sewage treatment service to 14 commercial and residential customers along the Bardstown Road area in Jefferson County, Kentucky.

TEST PERIOD

The Commission has adopted calendar year 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 appropriate known and measurable changes.

REVENUES AND EXPENSES

Fern Creek proposed adjustments to its test period revenues and expenses. The Commission finds the proposed adjustments and Fern Creek's test period operating results to be proper and acceptable for rate-making purposes with the following exceptions:

Electricity Expense

Fern Creek proposed an adjustment of \$224 to increase its test-period electricity expense. Based on the electric rates currently being charged by Louisville Gas and Electric Company, the Commission has determined that the proper adjustment should be to increase electricity expense by \$305. This results in adjusted electricity expense of \$3,288.

Maintenance of Treatment and Disposal Plant

During the test year Fern Creek incurred \$2,066 in expense for non-routine maintenance of its sewage treatment plant. The Commission has analyzed this expense and compared it to the expense levels incurred by Fern Creek in recent years. During calendar years 1980, 1981 and 1982, Fern Creek incurred expenses of \$549, \$1,274 and \$1,116, respectively, for maintenance of treatment and disposal plant. While the costs incurred during the test year were properly charged to operating expense during the period they were incurred, the Commission is of the opinion that

the test year expense, when compared to the prior years' expense levels, is not representative of normal operating conditions. The test year expense of \$2,066 represents an increase of 85 percent over the previous year's expense and a 111 percent increase over the average expense for the previous 3 years. Therefore, in order to reflect a more normal, representative level of expense for rate-making purposes the Commission has made an adjustment to reduce Fern Creek's test year expense by \$815 to \$1,251 to reflect the average annual expense for the 4-year period from 1980 through 1983.

Routine Maintenance Fee

Fern Creek reported routine maintenance service expense of \$4,200 for the test period and proposed no adjustment to this expense. Fern Creek's routine maintenance is performed by Andriot-Davidson's Service Company, Inc., ("Andriot-Davidson") which shares a common ownership with Fern Creek in that Mr. Carroll Cogan owns 100 percent of the stock of both companies. The maintenance contract between these two companies is, therefore, at less-than-arms-length. In order to determine the reasonableness of the \$350 per month maintenance fee, the Commission requested detailed information regarding the services provided, the basis for the determination of the monthly fee, and comparative information for all sewage plants serviced by Andriot-Davidson. The responses filed by Fern Creek were incomplete; therefore, the Commission was unable to compare the services provided to the various facilities being serviced by Andriot-Davidson.

Fern Creek indicated that it had not recently solicited competitive plant operating bids that could be compared to Andriot-Davidson's monthly fee. Therefore, no comparison was available to the Commission. Fern Creek indicated that Andriot-Davidson's monthly fee was based on an hourly rate of \$25; however, no support or analysis of this hourly rate was provided. In response to the Commission's inquiry as to whether Fern Creek had considered alternatives to contracting for routine maintenance, Fern Creek responded that the costs of hiring an employee and maintaining payroll records would preclude that alternative. However, no details were provided in support of that response.

The Commission has expressed its concern in other cases involving sewer utilities owned by Mr. Cogan about the rising costs of sewage treatment service and the increasing complexity of inter-company transactions. In this case there has been no change with regard to the unwillingness of Mr. Cogan to disclose information concerning transactions with affiliated companies. Therefore, the Commission is of the opinion that Fern Creek has failed to meet its burden of proof with regard to the test year level of expense for routine maintenance service.

In its evaluation of this matter the Commission has reviewed the annual reports filed by Fern Creek and has learned that Andriot-Davidson was charging a monthly fee of \$150 in 1977 when Mr. Cogan acquired the utility. Since that time, Fern Creek had not filed a rate application until the present case; therefore, the Commission has not had an opportunity to analyze and evaluate the level of routine maintenance expense. The

Commission presumes that the monthly fee of \$150 was adequate to cover Andriot-Davidson's costs in 1977; and Fern Creek has presented no persuasive evidence in this proceeding to indicate that a monthly fee of \$150 is not adequate to cover Andriot-Davidson's costs in 1985. It is the responsibility of this Commission to determine whether Fern Creek 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 Fern Creek has failed to make such a showing. Therefore, an adjustment is necessary to ensure that this level of expense is not borne by Fern Creek's ratepayers. To accomplish this, the Commission has made an adjustment which reflects a level of expense equal to the expense incurred at the time Mr. Cogan acquired the utility. Such adjustment reflects an annual expense level of \$1,800 or a decrease of \$2,400 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, Fern Creek is hereby apprised that the Commission will consider a motion for a formal hearing on this matter should Fern Creek indicate that it intends to submit persuasive proof in support of its test year expense for routine maintenance service.

Interest Expense

During the test year, Fern Creek reported interest expense of \$2,387. Of this amount, \$1,817 was reported as interest on debt to associated companies and \$570 was reported as other interest expense for a loan of \$4,642 from the Carroll Cogan

Companies Special Loan Account. The proceeds from these borrowings were used to support losses incurred by Fern Creek during the test year and in previous years. Fern Creek did not include this expense in the calculation of its pro forma revenue requirement; however, this was one of three expenses (the other two being depreciation and taxes) inadvertently omitted from the calculation. The Commission has partially corrected this oversight by adding back the amounts for depreciation and taxes. As has been stated in cases involving other utilities owned by Mr. Cogan, the recovery of interest on debt used to support past or present operating losses would constitute retroactive rate-making which is unlawful. In this case the Commission reiterates that position and, therefore, disallows the interest expense of \$2,387 for rate-making purposes.

Late Payment Charges

Fern Creek incurred \$3,103 in expense during the test year for late payment charges imposed by Andriot-Davidson due to Fern Creek's failure to remain current on its outstanding account. The failure by Fern Creek to meet its financial obligations in a timely manner is the responsibility of Fern Creek's management rather than its ratepayers. For this reason, recovery of these costs from ratepayers is inappropriate. Allowance of these late payments, or finance charges would constitute retroactive rate-making. As explained in the previous section, retroactive rate-making is unlawful and is not allowed by this Commission. Furthermore, the revenues granted herein should allow Fern Creek to remain current on its outstanding obligations, thus, eliminating

the late payment charges. Therefore, Fern Creek's test-period operating expenses have been reduced by \$3,103 to eliminate this expense for rate-making purposes.

Insurance Expense

Fern Creek incurred \$511 in expense for insurance premiums paid during the test year. Of this amount \$500 reflected the annual premiums for the years 1982 and 1983 for property and liability insurance. The Commission has reduced this amount by \$250 to reflect only the expense for 1 year as an appropriate expense for rate-making purposes. The Commission has also disallowed the remaining \$11 of insurance expense for rate-making purposes. This amount represents Fern Creek's allocated share of the annual premium for a life insurance policy on Mr. Cogan. This policy is carried for the stated purpose of covering personal guarantees to Mr. Cogan's many utilities; however, Mr. Cogan's estate is listed as the policy's beneficiary. As has been stated in recent cases involving other of Mr. Cogan's companies, the Commission is of the opinion that this policy is not of benefit to the customers of this utility and the expense thereof should not be allowed for rate-making purposes.

Based on the adjustments found acceptable herein, the Commission finds Fern Creek's adjusted test year operations to be as follows:

	<u>Actual</u>	<u>Adjustments</u>	<u>Adjusted</u>
Operating Revenues	\$ 7,983	\$ -0-	\$ 7,983
Operating Expenses	18,790	<5,974>	12,816
Operating Income	\$<10,807>	\$ 5,974	\$<4,833>
Interest Expense	2,387	<2,387>	\$ -0-
Net Income	<u>\$<13,194></u>	<u>\$ 8,361</u>	<u>\$<4,833></u>

REVENUE REQUIREMENTS

Fern Creek based its proposed revenue increase on an operating ratio of 88 percent. The Commission is of the opinion that the operating ratio is a fair and reasonable method for determining revenue requirements in this case and finds that an operating ratio of 88 percent will allow Fern Creek to pay its operating expenses and provide a reasonable return to its owners. Therefore, based on the adjusted operating expenses allowed herein and including a provision for income taxes, the Commission finds that Fern Creek is entitled to increase its annual revenues by \$7,184 to \$15,167.

SUMMARY

On January 14, 1985, Fern Creek submitted notice to the Commission of its intent to begin charging the rates advertised in its original application as of February 15, 1985. By letter, through its Secretary, the Commission notified Fern Creek on February 11, 1985, that it could not place its proposed rates in effect until 5 months and 20 days from the date of its application, or March 2, 1985. In its Order of February 28, 1985, the Commission ordered Fern Creek 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 was 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 Fern Creek should be denied upon application of KRS 278.030. Furthermore, the rate charged by Fern Creek on and after March 2, 1985, in excess of the rate approved herein should be refunded to the appropriate customers.

2. The rate in Appendix A is the fair, just and reasonable rate for Fern Creek and will produce gross annual revenue of \$15,167.

IT IS THEREFORE ORDERED that the rate in Appendix A be and it hereby is approved for service rendered by Fern Creek on and after the date of this Order.

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

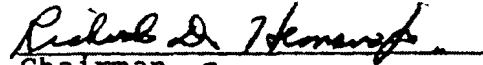
IT IS FURTHER ORDERED that within 30 days from the date of this Order, Fern Creek shall file with the Commission its revised tariff sheets setting out the rate approved herein.

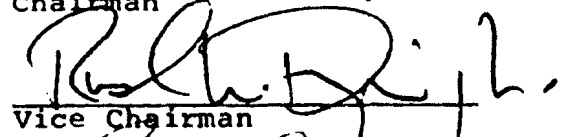
IT IS FURTHER ORDERED that the revenues collected by Fern Creek subsequent to March 2, 1985, through rates in excess of those found reasonable herein shall be refunded in the first billing after the date of this Order.

IT IS FURTHER ORDERED that Fern Creek shall file a statement within 30 days of the date of this Order reflecting the number of customers billed, and 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.

Done at Frankfort, Kentucky, this 12th day of March, 1985.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION IN CASE NO. 9137 DATED March 12, 1985.

The following rate is prescribed for customers in the area served by Fern Creek Sewer Company, Inc., 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 the Commission prior to the effective date of this Order.

Rate: Monthly

Commercial and Residential

270~~0~~ of Water Bill