

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF KEN IMPROVEMENT,))
INC., FOR AN ADJUSTMENT OF RATES))
PURSUANT TO THE ALTERNATIVE PRO-)) CASE NO. 9144
CEDURE FOR SMALL UTILITIES))

O R D E R

On September 25, 1984, Ken Improvement, Inc., ("Ken Improvement") 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.

Ken Improvement's proposed rates would produce additional revenue of approximately \$36,250 annually, an increase of 390 percent over reported test-period revenues. Based on the determination herein, the revenues of Ken Improvement will increase by \$13,446 annually, an increase of approximately 121 percent over test-period normalized revenues.

On March 8, 1985, Ken Improvement submitted notice to the Commission of its intent to begin charging the rates advertised in its original application as of March 17, 1985. In its Order of March 14, 1985, the Commission ordered Ken Improvement 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.

South Shelby Civic Association was granted leave to intervene in this case and a hearing was held in the offices of the Commission on April 11, 1985. The decision of the Commission is based on information contained in the application, written submissions, annual reports, the transcript of evidence from the hearing, and other documents on file in the Commission offices.

COMMENTARY

Ken Improvement is a privately-owned sewage treatment plant and serves approximately 138 residential customers in Shelby County, Kentucky.

TEST PERIOD

Ken Improvement proposed and the Commission has adopted the 12-month period ended June 30, 1984, 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, Ken Improvement reported a net loss from sewage operations of \$31,363. Ken Improvement proposed no adjustments to reported test-period revenues and expenses. The Commission has made the following adjustments, for rate-making purposes, to test-period revenues and expenses:

Revenue Normalization

Ken Improvement reported test-year operating revenues of \$9,290. In order to normalize annual operating revenues, the Commission has adjusted reported test-year operating revenues by \$1,798 to \$11,088, based on the number of customers and the monthly rates at the end of the test year.¹ Of the \$1,798 adjustment, \$1,657 is attributable to Ken Improvement's reporting operating revenues net of collection fees charged by Shelby County Water Company.

Salaries

Ken Improvement reported for the test period a management fee of \$1,575 and a fee of \$2,800 for bookkeeping services performed in-house.

In response to Item No. 7 of the Commission's information request of November 20, 1984, Ken Improvement stated that Mr. Keith Davis is responsible for all record-keeping and reports

¹ 83 customers x \$5.50 x 12 mos. = \$ 5,478
 55 customers x \$8.50 x 12 mos. = 5,610
 Total \$11,088

preparation which requires 80 hours per year. Therefore, compensation for Mr. Davis is at the rate of \$35 per hour.

The Commission, in Item No. 8 of its information request of January 22, 1985, requested Ken Improvement to provide the basis for the hourly rate of \$35. Ken Improvement's response was that the basis for the \$35 hourly rate for Mr. Davis was the bottom end of a range from \$35-\$50 which three professional accounting firms advised would be the rate charged.

In Item No. 9 of its information request of January 22, 1985, the Commission asked if Ken Improvement had considered less expensive alternatives to provide for record-keeping, such as hiring a part-time employee or contracting for bookkeeping services at a flat monthly fee. Ken Improvement's response was that it had not considered employing professional accountants.

It is the opinion of the Commission that Ken Improvement does not need to employ a professional accountant to provide bookkeeping services. Also, the Commission normally allows like-sized utilities with similar bookkeeping needs \$100 per month for bookkeeping services and finds no reason to depart from that practice in this instance.

Therefore, the Commission has included \$1,200 annually for bookkeeping services. The Commission has included the entire actual management fee of \$1,575, which results in total salaries allowed of \$2,775.

Repairs and Maintenance

Ken Improvement reported test-period repairs and maintenance expense of \$19,198. In response to Item No. 2 of the

Commission's information request of January 22, 1985, Ken Improvement provided copies of several invoices related to repairs and maintenance expense for the test period.

In Item No. 3 of the Commission's information request of January 22, 1985, Ken Improvement was asked if it felt any items expensed during the test period should have been capitalized. Ken Improvement's response was negative.

At the hearing on April 11, 1985, Mr. Keith Davis, who keeps the books and is an officer of Ken Improvement, was asked specifically about an invoice from Polley and Trent dated October 4, 1983, in the amount of \$4,655. When asked if he felt the cost of replacing 245 feet of sewer pipe should have been capitalized, Mr. Davis' response was negative. However, when asked if this work would need to be done on an annual basis, Mr. Davis admitted that it would not.

Mr. Davis was also asked if he felt the cost of a blower (invoice number 6539, dated 12-1-83) should have been capitalized. His response was negative, although he said he did not know how long the other blower was in service. When asked if the cost shown on invoice number 4858, dated 2-20-84, should have been capitalized, Mr. Davis' response was negative, although he said he did not know when that equipment was last replaced.

After review of the aforementioned invoices, the Commission is of the opinion that the items shown on invoice numbers 6539, 4858 and 2571 expensed during the test period represent capital improvements and should have been capitalized.

The items shown on invoice numbers 6539 and 4858 should be included in Account No. 373--Treatment and Disposal Equipment, while those shown on invoice number 2571 should be included in Account No. 352--Collection Sewers. The following table summarizes the Commission's treatment of these items that were inappropriately expensed.

<u>Invoice No.</u>	<u>Date</u>	<u>Amount</u>	<u>Appropriate Account No.</u>
6539	12/01/83	\$1,913	373
4858	2/20/84	537	373
2571	10/04/83	<u>4,655</u>	352
	Total	\$7,105	

After disallowance of \$7,105, the Commission has allowed test-period repairs and maintenance expense of \$12,093 for rate-making purposes herein.

Utilities

Ken Improvement reported test-period utilities expense of \$3,797. In response to Item No. 5 of the Commission's information request of November 29, 1984, Ken Improvement submitted copies of utility bills for the test period. Copies of those bills totaled only \$3,678 and no explanation was provided by Ken Improvement for the difference in the annual amount. Therefore, the amount of \$3,678 has been included herein for rate-making purposes.

Miscellaneous

Ken Improvement reported test-period miscellaneous expense of \$2,226. Included in that total were attorney's fees of \$1,464. A copy of a statement from Mitchell and Riggs in the amount of \$872 shows that the services provided were related to Case No.

8880, the Application of Ken Improvement, Inc., for a Certificate of Convenience and Necessity Authorizing Construction of Additional Sewage Treatment Plant.

A copy of another statement from Mitchell and Riggs in the amount of \$592 shows that the services provided were related to a case before the Department of Natural Resources and Environmental Protection. The Commission is of the opinion that this is an extraordinary expense which should not recur on an annual basis and has, therefore, disallowed it for rate-making purposes.

The Commission is of the opinion that the expense related to the case before this Commission regarding construction of additional sewage treatment plant is an extraordinary expense which should be recovered over a reasonable time period. Therefore, a provision has been made for amortization expense of \$291 to allow the recovery of this expense over a 3-year period and this amount has been included in that account for rate-making purposes. The Commission has allowed total adjusted miscellaneous expense of \$762 for rate-making purposes herein.

Agency Collection Fee

Ken Improvement reported no test-period agency collection expense. However, it was discovered by examination of material filed by Ken Improvement that Shelby County Water Company retained \$1,657 as a collection fee during the test period. Ken Improvement reported test-period operating revenues net of the collection fee and, therefore, had not made test-period charges to Account No. 903-A--Agency Collection Fee.

As explained in the section labeled "Revenue Normalization," the Commission has increased test-period operating revenues to reflect the gross amount that should have been collected. Therefore, the Commission has allowed the agency collection fee of \$1,657 as an operating expense for rate-making purposes herein.

Treatment Plant

In its Order of September 16, 1983, in Case No. 8880, the Commission granted a Certificate of Public Convenience and Necessity to Ken Improvement to proceed with its proposed construction project. As a part of its application in that case, Ken Improvement stated that, according to the estimate of its engineers, approximately \$20,000 would be expended on upgrading the quality of treatment by the existing 30,000 GPD plant.²

The Commission's Order of September 16, 1983, approved the proposed improvement to the existing 30,000 GPD treatment plant and the addition of 60,000 GPD additional capacity. The Commission's Order also stated that any deviations from the approved construction which could adversely affect service to any customer would be subject to the prior approval of this Commission.³

At the hearing in this case on April 11, 1985, the attorney representing the Commission asked Mr. H. A. Barnett, an officer of

² Supplement to Application filed September 8, 1983, in Case No. 8880, p. 2.

³ Commission's Order entered September 16, 1983, in Case No. 8880, p. 3.

Ken Improvement, if he had determined to abandon the old plant. Mr. Barnett replied that he had decided to abandon the old plant. When asked when that decision had been made, Mr. Barnett said it was made in 1984, after the new plant had been installed. ⁴

In Item No. 1 of the Commission's information request of March 14, 1985, Ken Improvement was asked to provide a breakdown of the portion of plant additions that should be allocated to increasing plant capacity in order to serve future additional customers, and details of the equipment installed for the purpose of upgrading the existing facilities and the installed cost of those facilities. In response, Ken Improvement said that the total cost of the added 60,000 gallons to bring the facility to a total of 90,000 gallons was \$111,997. The Commission's Order in Case No. 8880 granted a Certificate of Public Convenience and Necessity for a construction project at a total estimated cost of \$120,000. Since \$20,000 of that total was to be expended on upgrading the quality of treatment by the existing 30,000 GPD plant, a maximum of \$100,000 should have been expended on the 60,000 GPD addition. Therefore, it appears that Ken Improvement's expenditure exceeded that amount by approximately \$12,000.

There are two major issues involved in the addition to the sewage treatment plant. First, due to the installed customers on the system, there is a degree of excess capacity. Second, Ken Improvement deviated from the Commission's authorized construction plan in that approval was given to add 60,000 GPD additional

⁴ Transcript of Evidence, April 11, 1985, p. 103.

capacity to the existing 30,000 GPD plant to provide for existing customers and potential system growth; and, Ken Improvement completed construction of a new 60,000 GPD plant and abandoned its 30,000 GPD plant.

The Commission has some options as to how to treat this situation in fairness to both Ken Improvement and the ratepayers. If Ken Improvement had not anticipated additional growth in its development of this area, approximately 30,000 GPD of additional treatment plant capacity would have been adequate. Therefore, it would not be appropriate under the current circumstances to require the ratepayers to pay for the 60,000 GPD treatment plant which remains after abandonment of the 30,000 GPD plant.

On the other hand, the existing 30,000 GPD plant had operating deficiencies and was not adequate to provide the capacity requirements of the existing customers. In fairness to Ken Improvement and the ratepayers, the best approach would be to allow recovery of the cost associated with the upgrading of the existing plant and the cost of additional capacity required to serve the existing customers. This could not be done, however, in this case due to the failure of Ken Improvement to supply detailed information on the cost associated with upgrading the existing plant. Furthermore, the record does not contain sufficient information to determine what the cost would have been to add only the capacity required to serve the existing customers.

In addition to the issue of excess capacity, the Commission has concern over the management decisions which have led to the abandonment of the 30,000 GPD plant and the restrictions on the

addition of new customers imposed by the Division of Water of the Department of Environmental Protection.

In summary, Ken Improvement chose to deviate from the construction project approved by the Commission without obtaining the prior approval of this Commission. Furthermore, there is some degree of excess capacity and the Commission has not been able to determine the additional cost required to serve the existing customers. Therefore, the Commission has disallowed, for rate-making purposes, depreciation expense associated with the plant addition.

Depreciation Expense

As explained in a previous section labeled "Repairs and Maintenance," the Commission has determined that some items expensed during the test period should have been capitalized. The Commission is of the opinion that the items on Invoice No. 2571 should be depreciated over 40 years; those on Invoice No. 6539 over 10 years; and those on Invoice No. 4858 over 20 years. Therefore, the Commission has allowed total depreciation expense of \$334 for rate-making purposes herein.

Interest on Debt

In its Application filed August 3, 1983, in Case No. 8880, Ken Improvement stated that the new construction was to be fully financed by Kentucky Enterprises, Inc., a corporation having the same stockholders as Ken Improvement.

In Item No. 4 of its information request of February 25, 1985, the Commission asked Ken Improvement if it intended to find a long-term arrangement of financing. Ken Improvement's response was that it did not intend to find a long-term arrangement of

financing and that Kentucky Enterprises had no plans for Ken Improvement to secure the loans.

Ken Improvement has not requested and the Commission has not given approval of financing the additional sewage treatment plant construction authorized in Case No. 8880. Therefore, the Commission has disallowed, for rate-making purposes, the test-period interest expense associated with loans to finance the plant addition.

After consideration of the aforementioned adjustments, the Commission finds Ken Improvement's test-period operations to be as follows:

	<u>Actual Test Period</u>	<u>Pro Forma Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$ 9,290	\$ 1,798	\$ 11,088
Operating Expenses	<u>33,504</u>	<u><11,914></u>	<u>21,590</u>
Net Operating Income	\$<24,214>	\$ 13,712	\$<10,502>
Other Income	-0-	-0-	-0-
Other Deductions	<u>7,149</u>	<u><7,149></u>	<u>-0-</u>
Net Income <Loss>	<u>\$<31,363></u>	<u>\$ 20,861</u>	<u>\$<10,502></u>

REVENUE REQUIREMENTS

The Commission is of the opinion that the adjusted test-period operating loss is clearly unjust and unreasonable. Ken Improvement based its requested increase on an operating ratio methodology and requested revenue sufficient to produce a ratio of .88. The Commission is of the opinion that the operating ratio⁵ is a fair, just and reasonable method for determining revenue requirements in this case and finds that an operating ratio of 88

⁵ Operating Ratio = $\frac{\text{Operating Expenses}}{\text{Gross Revenue}}$

percent will allow Ken Improvement to pay its operating expenses and provide a reasonable return to its owners. Therefore, the Commission finds that Ken Improvement is entitled to an increase in annual revenue of \$13,446.

FINDINGS AND ORDERS

1. The rates in Appendix A are the fair, just and reasonable rates for Ken Improvement and will produce gross annual revenue of approximately \$24,534.

2. The rates proposed by Ken Improvement would produce revenue in excess of that found reasonable herein and should be denied upon application of KRS 278.030.

3. The rate charged by Ken Improvement on and after March 17, 1985, is in excess of the rate approved herein and, therefore, the difference should be refunded to the appropriate customers.

IT IS THEREFORE ORDERED that the rates in Appendix A be and they hereby are approved for service rendered by Ken Improvement on and after the date of this Order.

IT IS FURTHER ORDERED that the rates proposed by Ken Improvement be and they hereby are denied.

IT IS FURTHER ORDERED that the revenues collected by Ken Improvement subsequent to March 17, 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 Ken Improvement shall file with this Commission 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 17, 1985, the

number of customers receiving a refund, the amount refunded and the date of the refund.

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

Done at Frankfort, Kentucky, this 6th day of June, 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. 9144 DATED JUNE 6, 1985

The following rates and charges are prescribed for the customers receiving sewer service from Ken Improvements, Inc. 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>
Residential	\$ 14.82
Duplex	11.12