COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF GHK SEWERAGE CO. INC., FOR RATE ADJUSTMENT PURSUANT TO THE ALTERNATIVE RATE FILING PROCEDURE FOR SMALL UTILITIES	)	CASE NO. 9402

O R D E R

On August 14, 1985, GHK Sewerage Company ("GHK") 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"). GHK's revised proposed rates per the response filed October 21, 1985, would produce additional revenue of approximately $14,916 annually, an increase of 25.8 percent over test-year actual gross operating revenues of $57,914. Based on the determination herein, the revenues of GHK will increase by $8,309 annually, an increase of 14.35 percent over test-period actual gross operating revenues of $57,914.

A hearing was not requested in this matter and, in accordance with the provisions of the ARF, no hearing was held. Therefore, the decision of the Commission is based on information contained in the application, written submissions in response to requests for information, annual reports and other documents on file in this case.

COMMENTARY

GHK is a privately-owned sewage treatment system organized and existing under the laws of the Commonwealth of Kentucky and serving approximately 435 customers in Jefferson County.

TEST PERIOD

The Commission has adopted the 12-month period ending December 31, 1984, as the test year for determining the reasonableness of the proposed rates. In utilizing the historical test year, the Commission has given full consideration to known and measurable changes found reasonable.

REVENUES AND EXPENSES

GHK 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:

Management Fee

GHK proposed an adjustment of $1,600 to increase the test-year salary of $2,000 for Mr. J. S. Henderson, Jr., manager of GHK. 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 October 4, 1985, Item No. 2, the Commission requested GHK to provide any evidence as to why a manager's fee higher than $1,800 should be allowed in this case.

Mr. Henderson responded by stating the request for an increase was not based upon an increase in hours worked or increased responsibility but because the present fee is not commensurate with the value of the work performed in the present salary market. Mr. Henderson also raised the fact that the owner-manager should be compensated by the profit from the operation; however, GHK has attained the net income allowed by the operating ratio formula only twice since 1976. If Mr. Henderson 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 operating ratio and the resulting income found fair. The Commission cannot guarantee a utility will earn the income found fair in an Order, it can only provide the opportunity to earn that income. Actual earnings are directly related to management's actions.

Mr. Henderson has not proven that his involvement in the utility is any more demanding than other owner/management arrangements. Therefore, it is the Commission's opinion that GHK 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 for rate-making purposes.

Rate Case Expense

GHK proposed to include $200 as a pro forma adjustment for rate case expense. GHK stated that the excess over $200 will be spread over cost of operations in the next accounting year. In the response to the Commission's information request, GHK provided

a list and copies of invoices of actual expenses incurred to date totaling $736. The Commission is of the opinion that this expense should be amortized over a 3-year period. Therefore, the Commission has allowed, for rate-making purposes, a rate case expense of $245.

Uncollectible Accounts

GHK proposed in its application a pro forma adjustment of $2,216 for uncollectible accounts expense. In support of this adjustment, GHK stated that this expense has not been included in the operating statement because it is deducted from the gross billings by Louisville Water Company prior to sending GHK the net collections. Mr. Henderson stated that the net collections are shown as the operating revenue for the year. However, GHK did not propose an adjustment to operating revenues to reflect gross operating revenues.

GHK calculated the uncollectible expense by multiplying a flat rate of $11.25 per customer per month times the average number of customers of 435 times 12 months minus the actual net collections received of $56,509.

A review of the computer billing sheets of Louisville Water Company submitted with the response to the Commission's information request shows that the gross billings for GHK for 1984 total $57,914. Therefore, the Commission is of the opinion that operating revenues should be increased by $1,405 to reflect gross operating revenues.

The computer billing sheets state the amounts charged off and the amounts of prior charge-offs collected by Louisville Water

Company for each month. The Commission is of the opinion that this net figure is a fair representation of the test-year uncollectible expense and, therefore, has increased the operating expenses by $810.

GHK and all other sewer utilities regulated by this Commission are required to maintain their books in accordance with the Uniform System of Accounts for Sewer Utilities, which mandates the accrual basis of accounting. Under basic accrual accounting principles, operating revenues should reflect the amount of revenue billed, adjusted for any billing errors. The difference between revenue billed and collected should be maintained in accounts receivable and any amounts should be written off when collection is found to be improbable. GHK should follow this accrual method for reporting operating revenues by establishing and maintaining an Accounts Receivable from Louisville Water Company and writing off as an uncollectible expense amounts Louisville Water Company has charged off. This expense should be adjusted for any prior charged-off amounts collected in future periods.

Outside Services Employed

GHK has proposed a $1,000 adjustment to the Outside Services Employed Account. Due to recent actions by the Metropolitan Sewer District, some questions have arisen regarding the legal ownership of the collection systems and the treatment plants. The Waste Water Treatment Council of the Home Builder's Association of Louisville is defending the position of the plant owners and has asked each plant to donate $2.50 per customer to

pay for the legal costs. It is the Commission's opinion that this expense should be borne by the owners and not the ratepayers, since the owners are defending their position and would be the direct beneficiaries of the rights to ownership. Therefore, this proposed adjustment has not been allowed for rate-making purposes.

The Commission finds that GHK's adjusted test-period operations are as follows:

	Actual Test Period	Pro Forma Adjustments	Adjusted Test Period
Operating Revenue	$ 56,509	$ 1,405	$ 57,914
Operating Expense	53,996	4,921	58,917
Other Income	728	-0-	728
Net Income	$ 3,241	$<3,516>	$ <275>

REVENUE REQUIREMENTS

GHK proposed and the Commission agrees that the operating ratio[1] is a fair, just and reasonable method for determining revenue requirements in this case. The Commission finds that an operating ratio of 88 percent will allow GHK to pay its operating expenses and provide a reasonable return to its owners.

The use of an 88 percent operating ratio applied to the adjusted test-year operating expenses results in a revenue requirement of $66,951, after consideration of the Jefferson County occupational license tax. Therefore, the Commission finds that GHK is entitled to an increase in rates of $8,309 annually.

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1 $\text{Operating Ratio} = \frac{\text{Operating Expense and Taxes}}{\text{Gross Revenue}}$

SUMMARY

The Commission, after consideration of the evidence of record, finds that:

1. The rates proposed by GHK would produce revenues in excess of those found reasonable herein and should be denied upon appication of KRS 278.030.

2. The rates in Appendix A will produce gross annual operating revenue of $66,223 and are the fair, just and reasonable rates to be charged in that they will allow GHK to pay its operating expenses and provide a reasonable surplus for equity growth.

IT IS THEREFORE ORDERED that:

1. The rates proposed by GHK be and they hereby are denied.

2. The rates in Appendix A be and they hereby are approved for service rendered by GHK on and after the date of this Order.

3. Within 30 days of the date of this Order, GHK shall file its revised tariff sheets setting forth the rates approved herein.

Done at Frankfort, Kentucky, this 29th day of January, 1986.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 9402 DATED 1/29/86

The following rates and charges are prescribed for the customers in the area served by GHK Sewerage Co., 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.

RATES: Monthly

Residential	
Single Family	$12.70
Multi Family	
3 Bedroom	12.70
2 Bedroom	9.50
1 Bedroom	6.35
Non-Residential	$25.40