COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF CARDINAL UTILITIES, INC. FOR A RATE ADJUSTMENT PURSUANT TO THE ALTERNATIVE RATE FILING PROCEDURE FOR SMALL UTILITIES	) CASE NO. 89-336

O R D E R

Before the Commission is the application of Cardinal Utilities, Inc. ("Cardinal") for a rate adjustment pursuant to Commission Regulation 807 KAR 5:076. The proposed rate adjustment would produce additional annual operating revenues of $68,912, an increase of 110.6 percent. We deny the requested rate adjustment, but grant new rates producing an increase in annual operating revenues of $11,028 or 17.7 percent.

Cardinal operates a total of six sewage treatment plants providing sewer service to approximately 296 customers in Marshall, McCracken and Graves counties. It is a privately owned corporation incorporated under the laws of Kentucky.

Cardinal filed its application for rate adjustment on November 2, 1989. Subsequent thereto, the Utility and Rate Intervention Division of the Office of Attorney General ("AG"),[1]

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1 The AG did not formally move for leave to intervene in this proceeding. Commission Regulation 807 KAR 5:076, Section 5, provides that the AG will be deemed an intervenor in all alternative rate adjustment proceedings without making application therefor.

Action, Inc., and 62 individual residential customers of Cardinal were permitted to intervene in this proceeding. A hearing in this case was held in the Commission's offices in Frankfort, Kentucky, on July 17, 1990. At this hearing, Craig Steven Pope, president of Cardinal, and Commission Staff members Mark Frost and John Geoghegan offered testimony.

REVENUE REQUIREMENT DETERMINATION

Cardinal has proposed to use the 1988 calendar year, the last year for which complete data was available at the time of its application's filing, as its test period. Cardinal has proposed several adjustments to the test period levels. The Commission finds the 1988 calendar year to accurately reflect Cardinal's current operations and accepts its use as the test period. For purposes of brevity, we will discuss only those adjustments which are in dispute.

Operating Revenue

Cardinal reported test year revenue of $63,088. At the time its application was filed, it had 280 residential customers and 16 commercial customers. Based on Cardinal's present rates, this customer base generates $62,275 in annual revenues, a difference of $813.[2] Cardinal has suggested that the Commission also consider delinquent accounts in our calculation of operating

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[2]

Residential rate of $17.10 per month x 280 customers x 12 months	=	$57,456
Commercial rate of $25.10 per month x 16 customers x 12 months	=	4,819
Total Annual Revenue from rates		$62,275

revenues. As these delinquent account amounts are already included in these amounts, we find no reason to do so.

Operating Expenses

Supervisor and Engineering Expense. Cardinal proposed a pro forma level of supervision and engineering expense of $34,218, an increase of $15,000 above the test-period level.[3] The adjustment is based on its employment of an additional maintenance employee. In July 1990, Cardinal advised the Commission that another person was recently employed to operate its sewage treatment plants, that this person's hourly wage is $8.00, and that his normal work week is expected to be 35 hours.[4]

The Commission finds that the proposed adjustment fails to meet the rate-making criteria of known and measurable and, therefore, rejects it. Cardinal has failed to provide documentary evidence of this new employee despite requests for such proof. Furthermore, Cardinal has failed to demonstrate why its current practice of using contract labor on an as-needed basis to negate the need for an additional full-time employee is no longer adequate. The Commission remains unconvinced as to the need for an additional employee.

Testing Expense. In its application, Cardinal proposed no adjustment to test period testing expense of $960. Subsequently, Cardinal advised the Commission that the cost of such testing was

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3 Cardinal actually proposed a pro forma expense of $35,178. This expense include $960 for testing expense which has been treated herein as a separate item.

4 Memorandum of June 1, 1990 Informal Conference, 1-2.

$240 per month or $2,880 annually. It asserted that under the terms of a recent court order and the provisions of its Kentucky Pollutant Discharge Elimination System (KPDES) permit, it must test the effluent of its treatment plants monthly.[5] Based upon these mandatory requirements, the Commission finds that the proposed adjustment is known and measurable and should be accepted.

Legal fees. Cardinal proposed a pro forma level of legal fee expense of $5,000. The exact nature of these fees is unclear. Initially, Cardinal attributed these fees to its defense of civil actions[6] brought against it by the Natural Resources and Environmental Protection Cabinet for its failure to comply with water quality laws. Cardinal later contended these fees were not associated with such actions. The only documentary evidence in support of this adjustment is an itemized invoice showing test period legal fees of $844.

Of that amount, $337 was associated with tap-ons and $262 with rate case. The cost of tap-ons (i.e., labor and related expenses) is a capital expenditure which must be depreciated over the useful life of the associated asset. The useful life for tap-ons is 40 years. In a similar vein, rate case expenses are non-recurring expenses and have historically been amortized over a

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5 Id. at 2.

6 Natural Resources and Environmental Protection Cabinet v. Cardinal Utilities, Inc., No. 89-CI-0046 (Franklin Cir. Ct.).

three year period. Accordingly, the Commission finds that Cardinal's test-period operating expense should be increased by $340.[7]

Depreciation Expense. Cardinal proposed to expense pro forma plant repairs in the amount of $35,954. These repairs, as they represent capital expenditures, should be depreciated rather than expensed. Cardinal has, with the exception of additional manholes, which account for $12,500 of the total amount, provided adequate documentary evidence to support the need and cost of such repairs.

Cardinal has not, however, shown that it is capable of obtaining the financing needed to purchase these items. Cardinal has submitted a letter from People's First National Bank and Trust Company ("Peoples Bank") wherein Peoples Bank states its intention to lend $3,000 to Cardinal to upgrade its waste disposal systems. This letter, however, fails to state an interest rate, a term of loan or an effective loan date. Nothing in the record, furthermore, indicates the loan's precise purpose. Accordingly, the Commission finds that the proposed adjustment fails to meet the criteria of being known and measurable and rejects it.

Miscellaneous General Expense. Cardinal reported miscellaneous general expense of $957 which includes telephone

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Legal Fees	$244		$244
Tap-ons	337	÷40 years =	8
Rate Case	263	÷ 3 years =	88
Total	$844		$340

expense of $438. Commission Staff recommended that this telephone expense be disallowed as it was personal rather than business related. The Commission, after thoroughly reviewing the invoices supporting these expenses, agrees with Commission Staff that these expenses are personal to Cardinal's president and should be rejected.

Emergency Expense. Cardinal proposed a *pro forma* level of emergency expense of $2,000. According to Cardinal's president, the utility needs a readily available source of funds to meet unexpected expenses. Without such funds, he contends, it is difficult to make needed repairs or purchase required equipment.[8] Cardinal has not presented any evidence to support this expense nor has it provided any explanation as to how the level of the expense was determined. Given the lack of such supporting evidence, the Commission finds that the proposed expense is neither known nor measurable and, therefore, rejects it.

Interest Expense. Cardinal reported interest expense of $4,175 for the test period. This interest is associated with a loan obtained from People's Bank by Larraine Kimbrell, Cardinal's owner of record, to finance the purchase of all of Cardinal's sewage treatment facilities. Upon purchasing these facilities, Ms. Kimbrell exchanged these assets for Cardinal stock. As such, the loan must be characterized as Ms. Kimbrell's personal debt, not Cardinal's. The assets exchanged by Ms. Kimbrell must be

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8 Memorandum of June 1, 1990 Informal Conference, 2.

considered as investment and classified as owner's equity in Cardinal. Accordingly, the interest expense associated with Ms. Kimbrell's loan should not be included in Cardinal's operation. As the Commission has made provision for return on equity in the rates established in this Order, Ms. Kimbrell will be receiving a return on her investment.

OPERATIONS SUMMARY

The Commission has determined Cardinal's operating statement to be as follows:

	Test-Year Actual	Adjustments	Test-Year Adjusted
Operating Revenues:			
Measured Revenues	$63,088	<$813>	$62,275
Operating Expenses:			
Fuel & Power	8,450	1,347	9,797
Chemicals	2,489	0	2,489
Supervision & Engineering	19,218	0	19,218
Testing	960	1,920	2,880
Office Salary-Secretary	5,000	1,500	6,500
Maintenance	3,397	<1,000>	2,397
Office Supplies & Other Expenses	4,067	<1,540>	2,527
Outside Services	450	450	900
Legal Fees	0	244	244
Insurance	2,422	320	2,742
Regulatory Commission Expense	2,060	<192>	1,868
Transportation	3,824	0	3,824
Miscellaneous General	957	<438>	519
	$53,294	$2,611	$55,905

Total Operation & Maintenance Expense:			
Depreciation Expense	7,844	460	8,304
Amortization Expense	0	88	88
Taxes Other than Income Taxes	210	0	210
Total Operating Expenses	$61,348	$3,159	$64,507
Net Operating Income	$1,740	<$3,972>	<$2,232>
Other Deductions			
Interest on Long-Term Debt	4,175	<4,175>	0
Net Income	<$2,435>	$203	<$2,232>

REVENUE REQUIREMENTS

For small, privately owned sewage utilities like Cardinal, the Commission has previously held that the operating ratio method should be used for rate-making determination. This method is used because "the books, records and accounts of many of these utilities are incomplete" and further because no comparable utility exists upon which to base a rate of return determination.[9]

The Commission finds that an 88 percent operating ratio is the appropriate operating ratio to use in determining Cardinal's revenue requirement. Based upon such a ratio Cardinal requires annual operating revenues of $73,303, or additional operating income of $11,028.[10] An 88 percent ratio will, furthermore,

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9 Case No. 7658, An Adjustment of Rates of the Lee Angle Company, Inc., Order of May 30, 1980.

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Adjusted Operating Expenses	$64,507
Operating Ratio	+ .88
Total Revenue Requirement	$73,303
Normalized Revenues	<62,275>
Increase Required	$11,028

result in a net cash flow of $17,188[11] and provide sufficient revenues for Cardinal to meet its operating expenses and receive a reasonable return.

RATE DESIGN

In its application, Cardinal did not propose any changes to its present rate design. At hearing, its president suggested that a significantly higher share of any rate increase be attributed to Cardinal's commercial customers. His suggestion was based in large measure on the belief that Cardinal's commercial customers were imposing a much larger portion of costs on the utility than were residential customers. Despite representations that evidence would be submitted following the hearing to support these claims, Cardinal has yet to produce any evidence on this point. In the absence of such evidence, the Commission finds that Cardinal's existing rate design is reasonable and that the existing rate structure should remain in place.

SUMMARY

After consideration of the evidence of record and being otherwise sufficiently advised, the Commission finds that:

1. Cardinal requires gross annual operating revenues of $73,303 to meet its operating expenses, to ensure an adequate cash

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Revenue Requirement	$73,303
Adjusted Expenses	<64,507>
Subtotal	$8,796
Add: Depreciation Expense	8,304
Amortization Expense	88
Net Cash Flow	$17,188

flow and to provide a fair, just, and reasonable return on its investment.

2. The rates in Appendix A, attached hereto and incorporated herein, are the fair, just, and reasonable rates for Cardinal and will produce gross annual operating revenues of approximately $73,303 based on adjusted test-year sales.

3. The rates proposed by Cardinal will produce revenues in excess of that found reasonable herein.

IT IS THEREFORE ORDERED that:

1. The rates contained in Appendix A are approved for service rendered on and after the date of this Order.

2. The rates proposed by Cardinal are denied.

3. Within 30 days of the date of this Order, Cardinal shall file with the Commission its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 31st day of August, 1990.

PUBLIC SERVICE COMMISSION

Chairman

Robert M. Davis
Vice Chairman

Jim Thompson
Commissioner

ATTEST:

Lee M. Macfarlane
Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 89-336 DATED 8/31/90

The following rates and charges are prescribed for the customers in the area served by Cardinal Utilities, 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.

Monthly Rates

Residential	$20.45
Commercial	29.90