

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

| | | |
|--------------------------------|---|-----------------|
| THE APPLICATION OF 4-WAY |) | |
| ENTERPRISES, INC., COOLBROOK |) | |
| SANITATION DIVISION FOR A RATE |) | CASE NO. 98-284 |
| ADJUSTMENT PURSUANT TO THE |) | |
| ALTERNATIVE RATE FILING |) | |
| PROCEDURE FOR SMALL UTILITIES |) | |

O R D E R

On May 27, 1998, 4-Way Enterprises, Inc., Coolbrook Sanitation Division (4-Way) filed an application pursuant to Administrative Regulation 807 KAR 5:076 for a proposed adjustment in its rates for sewer service. 4-Way determined its pro forma revenue requirement to be \$154,930, an increase over test-year revenues of \$63,835. The application was amended on July 21, 1998 to include additional annual expenses in the amount of \$677. Granted intervention in the case were the Attorney General of the Commonwealth of Kentucky, Mary A. Morris, Mr. and Mrs. Duane Redmon, and Rhonda Pack individually and as spokesperson for protesting customers.

Commission Staff performed a limited financial review of 4-Way's test-period operations¹ and issued a Staff Report on August 25, 1998. The Staff Report recommended that 4-Way be authorized an annual revenue requirement of \$109,318

¹ The test period for determining 4-Way's revenue requirements was Calendar Year 1997.

or a \$15,002 increase over normalized revenues. By Order dated August 25, 1998, the parties were advised to file comments on the Staff Report or to request a hearing or an informal conference within 10 days of the date of the Order. 4-Way, the only party to respond, filed written comments on September 4, 1998 expressing its disagreement with Commission Staff's recommendations with regard to the owner/manager fee, the depreciation on contributed property and the billing and collection expense.

The Commission finds that certain adjustments were required to be made to the Staff Report of August 25, 1998. These adjustments were due in part to the Supplemental Response to the Staff Report filed by 4-Way on September 10, 1998, providing additional documentation for rate case expenses. As a result, 4-Way incurred total rate case expenses of \$4,196. When amortized over a period of three years, this results in annual rate case expense of \$1,399, or an increase of \$66 over the annual amortization of rate case expense allowed in the Staff Report. The additional adjustment was required when a review of the Staff Report revealed a mathematical error in calculation of the Recommended Operating Expenses on Attachment B of the Staff Report. A revised Statement of Operations and Calculation of Revenue Requirement are shown in Appendices B and C, respectively.

As the parties to this case have accepted the majority of Commission Staff's findings and recommendations, the Commission addresses with specificity only those issues in dispute.

Owner/Manager Fee

4-Way paid its owner a management fee of \$4,800 during the test year. Commission Staff recommended that \$1,200 be disallowed and the fee limited to \$3,600. 4-Way contends that the \$4,800 paid its manager is a fair and reasonable fee. It further contends that the Commission, in limiting this fee to \$3,600, relies on an unwritten policy of limitation in violation of KRS 13A.100.

The Commission finds 4-Way's argument unpersuasive. Each and every case of this type is reviewed individually by Commission Staff and a determination made as to the fair, just and reasonable fee to compensate the management for duties performed for the utility. The Commission finds that minimal attention is required by the manager of 4-Way as it is a relatively small utility² the primary operations of which -- operation and maintenance, billing and collection, and sludge hauling -- are performed by contractors. Accordingly, the Commission finds the \$3,600 owner/manager fee recommended by Staff to be fair, just and reasonable.

Depreciation

Commission Staff reviewed 4-Way's depreciation expense and recommended an adjustment to decrease the test-year amount by \$10,273 to exclude depreciation on contributed property as 4-Way is a privately owned utility. 4-Way disagrees with Staff's recommended disallowance, arguing that the effect of the Supreme Court of Kentucky's holding in Public Service Commission v. DeWitt Water District, Ky., 720 S.W. 2d 725 (1986) is to place publicly owned utilities in the same position as privately owned utilities by allowing them to depreciate contributed property.

² 4-Way currently serves 426 customers.

The Commission disagrees with 4-Way's interpretation of DeWitt. The Kentucky Supreme Court clearly and specifically excluded private, investor-owned utilities from its holding:

Depreciation expense on contributed plant property may be considered as an operating expense for rate-making purposes in matters involving publicly held water districts as distinguished from investor owned companies.

Id. at 728.

The Court reasoned that, in contrast with private, investor-owned utilities, publicly owned utilities have no private investor capital and their rates do not generate a return on rate base.³ Permitting 4-Way, a privately owned utility, to recover depreciation on contributed property through its rates would result in its investors receiving a windfall while its ratepayers are compelled to pay twice for the same facilities. Accordingly, the Commission finds that test-year depreciation expense should be decreased by \$10,273 to exclude depreciation on contributed property.

Billing and Collection

4-Way is currently under contract with Farmdale Water District (Farmdale) for the billing and collection of its sewer bills. Farmdale charges 4-Way 15 percent of the total revenues collected in exchange for these services.

For the test year 4-Way incurred billing and collection expenses of \$13,664. An adjustment was proposed to increase this amount by \$9,477, to a level of \$23,141 as a result of the proposed increase in revenues. Based on the current level of customers, this proposed increase in revenues would increase the cost per bill from the test year

³ Id. at 732.

amount of \$2.67 to \$4.53. The Staff Report issued on August 25, 1998 recommended that the billing and collection expense remain at the test year level of \$13,664.

In its comments filed September 4, 1998, 4-Way argues that the Public Service Commission has no legal basis to disallow the expense associated with the contract because the contract was approved in a prior case, but that in the event it does find the expense unreasonable, it has the authority to void the contract. The Commission finds that while it does not have the authority to void this contract for non-utility service as 4-Way asserts, KRS 278.040 specifically empowers it with jurisdiction over the regulation of rates and services of utilities. This authority and duty to regulate utility rates and services carries with it the power to disallow costs deemed unreasonable.

The Commission, on its own motion, scheduled a hearing for January 19, 1999 at 10:00 a.m., Eastern Standard Time, to determine the reasonableness of the billing and collection rates proposed by 4-Way. Notice was given to all parties of record informing them that the sole issue to be covered at the hearing was the billing and collection rates proposed by 4-Way and informing 4-Way that it should appear and present evidence sufficient to show that the rate or charge proposed for billing and collection was just and reasonable.

Evidence was presented at the hearing by Commission Staff that in 1982⁴ and again in 1991⁵ 4-Way made application to this Commission for a rate increase. In both cases the subject contract between Farmdale and 4-Way was in issue. It is

⁴ Case No. 8493, Notice of Adjustment of Rates of 4-Way Enterprises, Inc., d/b/a Coolbrook Sewage Treatment Plant to Become Effective April 20, 1982.

⁵ Case No. 91-394, The Application of Four-Way Enterprises, Inc. for Rate Adjustment Pursuant to the Alternative Rate Filing Procedure for Small Utilities.

unmistakably clear from the Commission's Order in 1982 that it believed the billing and collection expense should be based on actual costs rather than revenues.⁶ It is also unmistakably clear from the language contained in the Staff Report in Case No. 91-394,⁷ which was later adopted by the final order in that case,⁸ that there was no approval of the billing and collection contract. On the contrary: the Staff Report adopted by the Commission specifically noted its concerns, which have been reiterated in the present case, regarding the billing and collection agreement. Furthermore, the utility was put on notice that it would be required in its next application to demonstrate that its billing and collection agreement with Farmdale is prudent and reasonable in light of other alternative methods available to it.

Commission Staff also presented evidence that it had collected data on the billing and collection expenses of other utilities that, like 4-Way, have their billing and collection performed by water districts.⁹ Similarly situated utilities, e.g., those sewer utilities whose bills are issued by water utilities, were chosen so that any advantage or disadvantage associated with having a water utility do the billing and collection would be included. Staff testified that after collecting the data a calculation was performed to arrive at an average per bill cost for the service. The average cost was found to be

⁶ Order of November 4, 1982, Case No. 8493, Staff Exhibit 3, Transcript of January 19, 1998 Hearing (Transcript).

⁷ Order and Staff Report of January 30, 1992, Case No. 91-394, Staff Exhibit 1, Transcript.

⁸ Order of February 18, 1992, Case No. 91-394, Staff Exhibit 2, Transcript.

⁹ Transcript at 12-14.

\$2.00 per bill.¹⁰ 4-Way's present expense for billing and collection is \$13,664, or a per bill charge of \$2.67.¹¹ While the Commission does not set rates based on industry averages, it does find the average charge for this service relevant as a measure of the reasonableness of 4-Way's expense.

Appearing and testifying before the Commission on behalf of 4-Way was its president, Carl Sturgeon. Although Mr. Sturgeon presented evidence that 4-Way has zero uncollectable accounts¹² and that it has never experienced a problem with Farmdale's services,¹³ both of which the Commission finds important and desirable, he failed to provide evidence sufficient to prove that the proposed increase in billing and collection is fair, just and reasonable. Mr. Sturgeon merely asserted that 4-Way had a valid contract with Farmdale that calls for payment of 15 percent of 4-Way's revenues. However, he admitted that the contract between Farmdale and 4-Way is renewable every five years and that it was renewed without an attempt by 4-Way to renegotiate the terms of the contract.

After reviewing the record, the Commission concurs with Commission Staff's recommendation that the billing and collection expense not be increased from the test year level of \$13,664. In addition, it finds that when filing its next application 4-Way should be required to present evidence that its billing and collection expense is

¹⁰ Transcript at 14.

¹¹ Transcript at 15-16.

¹² Transcript at 90.

¹³ Transcript at 86.

reasonable. Reasonableness may be presumed if 4-Way advertises and receives public bids for its billing and collection.

Conclusion

Having considered the evidence of record and being otherwise sufficiently advised, the Commission finds that:

1. In addition to the specific findings contained in this order with regard to the owner/manager fee, the depreciation on contributed property, and the billing and collection expense, the recommendations and findings in the Staff Report, with the amendments set forth above, are supported by substantial evidence, are reasonable, and should be adopted as the findings of the Commission.

2. The rates in Appendix A to this Order are the fair, just and reasonable rates for 4-Way and will produce gross annual revenues of \$113,603.

3. These rates will allow 4-Way sufficient revenues to meet its operating expenses.

4. The rates proposed by 4-Way will produce revenue in excess of that found reasonable herein and should be denied.

IT IS THEREFORE ORDERED that:

1. The rates proposed by 4-Way in its application are denied.

2. The rates in Appendix A of this Order are approved for services rendered by 4-Way on and after the date of this Order.

3. Within 30 days of the date of this Order, 4-Way shall file with the Commission its revised tariff setting out the rates approved herein.

4. 4-Way, in its next application, shall produce evidence sufficient to show that its billing and collection expense is reasonable based on the cost of providing the service.

5. The findings contained in the Commission Staff Report of August 25, 1998, adjusted as described herein, are adopted and incorporated by reference into this Order as if fully set out herein.

Done at Frankfort, Kentucky, this 25th day of March, 1999.

By the Commission

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 98-284 DATED MARCH 25, 1999

The following rate is prescribed for the customers in the area served by 4-Way Enterprises, 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>Monthly Rate</u> |
|---------------------------|---------------------|
| Single-Family Residential | \$22.22 |

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 98-284 DATED MARCH 25, 1999

| | Test Year per Annual Report | Recommended Adjustments | Recommended Test Year |
|----------------------------------|--------------------------------|----------------------------|--------------------------|
| Operating Revenues | 91,095 | 3,221 | 94,316 |
| Operating Expenses: | | | |
| Supervision | 4,800 | (1,200) | 3,600 |
| Labor & Exp. | | | |
| Collection System Expense | 1,369 | | 1,369 |
| Pumping System Expense | 1,574 | | 1,574 |
| Sludge Hauling | 15,450 | | 15,450 |
| Utility Service - Water Cost | 544 | | 544 |
| Other Labor, Materials, & Exp. | 25,305 | (11,932) | 13,373 |
| Fuel & Power Purchased | 10,503 | | 10,503 |
| Chemicals | 1,734 | 2,458 | 4,192 |
| Routine Maintenance | 6,950 | 4,450 | 11,400 |
| Maintenance | 3,893 | | 3,893 |
| Collection Expense | 13,664 | - | 13,664 |
| Office Expense | 111 | | 111 |
| Outside Services | 1,312 | | 1,312 |
| Insurance Expense | 2,474 | | 2,474 |
| Miscellaneous Expense | 85 | (60) | 25 |
| Depreciation Expense | 16,766 | (5,970) | 10,796 |
| Amortization Expense | - | 1,399 | 1,399 |
| Taxes Other than Income Taxes | 1,511 | - | 1,511 |
| Total Operating Expenses | <u>108,045</u> | <u>(10,855)</u> | <u>97,190</u> |
| Operating Income | (16,950) | 14,076 | (2,874) |
| Interest Expense | <u>10,872</u> | <u>(10,872)</u> | <u>-</u> |
| NET INCOME | <u>(27,822)</u> | <u>24,948</u> | <u>(2,874)</u> |

APPENDIX C

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 98-284 DATED MARCH 25, 1999

| | Requested by 4-Way | Recommended by Staff |
|---|-----------------------|-------------------------|
| Adjusted Operating Expenses | 135,751 | 97,190 |
| Operating Ratio | 0.88 | 0.88 |
| Required Operating Revenue before Income Taxes | | 110,443 |
| Less: Adjusted Operating Expenses | | <u>97,190</u> |
| Revenue Subject to Income Taxes | | 13,253 |
| Gross-Up Factor | | <u>1.23839</u> |
| Net Operating Income Inclusive of Provision for Income Taxes | | 16,413 |
| Add: Adjusted Operating Expenses | | <u>97,190</u> |
| Revenue Requirement | 154,263 | 113,603 |
| Add: Increase per Amended Application | <u>667</u> | - |
| Amended Revenue Requirement | 154,930 | 113,603 |
| Less: Normalized Test-Year Revenue | <u>91,095</u> | <u>94,316</u> |
| Required Increase | <u><u>63,835</u></u> | <u><u>19,287</u></u> |