

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF COMMONWEALTH)	
WASTEWATER SYSTEMS, LLC FOR A)	
CERTIFICATE OF CONVENIENCE AND)	CASE NO. 2003-00431
NECESSITY, INITIAL RATES AND)	
AUTHORITY TO OPERATE)	

O R D E R

Commonwealth Wastewater Systems, LLC (“Commonwealth”) has applied to the Commission for a Certificate of Public Convenience and Necessity (“Certificate”) to construct a new wastewater system, for approval to establish initial rates that produce annual revenues of \$12,204,¹ for approval to establish non-recurring charges, and for authority to operate said system. By this Order, we grant the requested Certificate, approve the proposed non-recurring charges, deny the proposed rates, and approve rates that will produce annual revenues of \$10,476.²

BACKGROUND

Commonwealth, a limited liability company formed under the laws of Kentucky, proposes to construct and operate sewage treatment facilities to provide retail sewer service to approximately 25 customers in the Wandering Hills Subdivision of Boyle County, Kentucky. Upon the completion of the proposed construction and the

¹ \$40.68 (Proposed Monthly Rate) x 25 (Customers) x 12 Months = \$12,204.

² \$34.92 (Approved Monthly Rate) x 25 (Customers) x 12 Months = \$10,476.

commencement of their operations, Commonwealth will be a utility subject to Commission jurisdiction. KRS 278.010(3)(f); KRS 278.040.

PROCEDURE

Commonwealth tendered its application on November 21, 2003. This application was not considered filed until January 26, 2004, when Commonwealth cured certain deficiencies in its application. The Attorney General (“AG”) is the only intervenor in this proceeding. He submitted a request for information to Commonwealth on January 15, 2004, to which Commonwealth has fully responded. On February 24, 2004, Commonwealth moved that we expedite our review of the portions of the application related to the Certificate to permit the proposed construction. No party has requested a hearing in this matter.³

PROPOSED CONSTRUCTION

The proposed construction project consists of approximately 4,300 lineal feet of 4-inch and 3-inch PVC sewer mains, a recirculating media filter treatment plant, two subsurface drip dispersal fields, and related appurtenances to provide new sanitary sewer service to approximately 25 customers. Each customer will be responsible for the installation of a 1500-gallon interceptor septic tank and appurtenances as specified in Commonwealth's tariff. Commonwealth will maintain the interceptor septic tank after connection to the collection system. Conventional onsite septic tanks and lateral fields cannot be supported by the relatively poor soil conditions, and a connection to the city of Danville's sewer system is uneconomical due to the distance to connect. The

³When he moved for intervention, the AG also requested the establishment of a procedural schedule in this matter. He subsequently withdrew his request and advised

estimated cost of the proposed project is approximately \$105,000. Rolan Coulter, the developer of the Wandering Hills Subdivision, will assume the cost of the project and donate it to Commonwealth as a contribution in aid of construction.

DISCONNECTION POLICY

Commonwealth proposes to impose as a condition of service that customers must install a shutoff valve on the customer's side of his or her water meter.⁴ Commonwealth intends to use this valve to discontinue a customer's water service when the customer has failed to make timely payment for service or otherwise failed to comply with the utility's rules.⁵

While the Commission views Commonwealth's proposal as an intriguing approach to a problem that has long plagued sewer utilities,⁶ we are not convinced of its reasonableness. While the proposal allows the sewer utility to limit the customer's access to water service, it contains no provision for notice to the customer regarding the sewer utility's use of the shutoff valve. Customers should be fully aware of the purpose of the valve and the circumstances under which it will be used to deny the customer service. The sewer utility's tariff should provide the specific manner and form of notice that will be given to a customer. Moreover, since the practical effect of the use of the shutoff valve is to deprive the customer of water service, some notice and coordination

the Commission that he does not object to submission of this matter for decision on the existing record.

⁴This condition is found in the utility's proposed Sewer Subscription Contract. See Application, Exhibit 9.

⁵Commonwealth's Response to AG's Request for Information, Item 11.

⁶See Collection and Billing Practices of Privately Owned Sewer Utilities, Administrative Case No. 347 (Ky. PSC Jan. 9, 1995).

with the servicing water utility is necessary. Commonwealth's proposal is silent on these aspects. Commonwealth has also failed to address the effect of such valve on the servicing water utility's facilities and operations.

Accordingly, we find that Commonwealth has failed to demonstrate that the proposed condition of service is reasonable and that the proposed condition should be stricken from its sewer subscription contract. If Commonwealth wishes to pursue the use of a shutoff valve as a condition of service, it may do so by separate application or filing. Such application should address the issues noted above.

TEST PERIOD

As Commonwealth has yet to begin operations, test-period financial information is nonexistent. The Commission, therefore, is relying upon reasonable estimates and projections of Commonwealth's revenues and expenses.

PROJECTED REVENUES AND EXPENSES

Commonwealth projected operating expenses of \$11,440⁷ based on providing sewer service to 25 residential customers. Our review of these proposed operating expenses is set forth below.

Capital Escrow

Commonwealth proposes to include in its proposed monthly rate an amount that will be escrowed for future capital expenditures. The annual escrow for the proposed capital expenditures is \$3,906. The following table includes the amounts that Commonwealth intends to escrow:

⁷ Application, Exhibit 13, Ordinary Income/Expenses.

<u>System</u>	<u>Description</u>	<u>Replacement Period</u>	<u>Monthly Escrow</u>	<u>Annual Escrow</u>
Collection	Tank Painting	4 Years	\$ 5.41	\$ 1,623
Collection	Equipment Replacement	20 Years	3.83	1,149
Treatment	Equipment Replacement	20 Years	2.90	870
Disposal	Equipment Replacement	20 Years	+ 0.88	+ 264
Escrow Totals			<u>\$ 13.02</u>	<u>\$ 3,906</u>

In establishing rates for a new utility that does not have actual operations, the Commission relies upon reasonable estimates and projections of the annual costs that will be incurred by the utility. In this instance Commonwealth is proposing to recover in its base rates projected capital expenditures that it expects to incur sometime within the next 20 years.

The Commission finds that the number of factors affecting future capital expenditures is so great as to make an accurate prediction of those future costs impossible. The Commission further finds that Commonwealth's proposal is an unreasonable effort to insulate Commonwealth from its obligation to make adequate capital investment in its operations by requiring ratepayers to fund those expenditures before they are incurred and before ratepayers enjoy any benefit from them. For these reasons, the Commission denies Commonwealth's proposal to include the annual escrow of \$3,906 in its pro forma operating expenses.

Owner/Manager Fee

Commonwealth did not include an owner/manager fee in its operating expense projections. The responsibilities of the typical owner and operator are to oversee the management of Commonwealth and to ensure that the treatment facilities operate and conform to the appropriate statutory and regulatory requirements. Therefore, the

Commission finds that the owner/manager of Commonwealth is entitled to receive a reasonable level of compensation.

In the past, the Commission has allowed owner/managers of similarly sized utilities with comparable responsibilities to recover for rate-making purposes owner/manager fees of \$3,600. The Commission is of the opinion that an owner/manager fee of \$3,600 is warranted in this instance and has included that amount in test-period operating expenses.

Electricity

Commonwealth estimates that, for sewage treatment systems similar to the proposed facilities, with fixed pump stations, fixed film treatment, and drip irrigation, the average monthly electricity cost is \$2.30 per customer. We find this estimate to be reasonable. Using Commonwealth's cost estimate the Commission calculates an electricity expense of \$690.⁸ Accordingly, the Commission has included in its pro forma operating expenses electricity expense of \$690.

Telephone-Telemetry

The remote telemetry that Commonwealth will use at its treatment system and pump station requires a commercial telephone line at each location. Commonwealth has provided a price quote from BellSouth Telecommunications, Inc. showing that the cost per commercial line is \$58 per month. Therefore, the Commission includes in its pro forma operating expenses a telephone expense of \$1,392⁹ to reflect the annual operating cost of the telemetry system.

⁸ \$2.30 x 25 (Customers) x 12 Months = \$690.

⁹ \$58 (Cost per Telephone Line) x 2 Lines x 12 Months = \$1,392.

Testing

Commonwealth estimates that the cost per sample event will be \$315, which is also its proposed annual expense. Commonwealth asserts that its estimate “[i]s based on preliminary experience with contracting for these services and the expected permit requirements by the state.”¹⁰ The Commission finds that Commonwealth’s estimate is reasonable and has included testing expense of \$315 in its pro forma operating expenses.

Maintenance

The Commission calculates a maintenance expense of \$2,223.¹¹ As the proposed facilities will be newly constructed and should not require extensive maintenance in their initial years of operations, the Commission finds that an annual maintenance expense of \$2,223 is within the range of reasonableness and has included this level in its pro forma operating expenses.

Billing and Collection

Commonwealth has a verbal commitment from Inter County Energy Cooperative to perform its billing and collection services for this initial project. According to Commonwealth, its telephone survey of potential billing services produced a range in

¹⁰ Application, Exhibit 10, Reference No. 5, Sampling Testing and Reporting Requirements.

¹¹ Collection System:

Preventive Maintenance \$1.50 x 25 (Customers) x 12 Months =	\$	450
Service Calls \$1.50 x 25 (Customers) x 12 Months =		450
Treatment System:		
Preventive Maintenance \$3.41 x 25 (Customers) x 12 Months =		1,023
Trouble Calls \$1.00 x 25 (Customers) x 12 Months =	+	300
Annual Maintenance	\$	<u>2,223</u>

monthly fees of \$1.50 to \$3.00 per customer. Commonwealth proposes to use the monthly billing and collection fee of \$1.50 per customer.¹² Using this fee, the Commission calculates its pro forma annual billing and collection expense of \$456.¹³

Property Tax

Commonwealth projects a property tax expense of \$298.¹⁴ In reviewing Commonwealth's projection, the Commission is of the opinion that it is reasonable and has included property taxes of \$298 in its pro forma operating expenses.

Summary

The Commission, after considering the pro forma adjustments found reasonable herein, has determined that Commonwealth's pro forma operating expenses would be as follows:

Owner/Manager Fee	\$ 3,600
Electricity	690
Telephone – Telemetry	1,392
Maintenance	2,223
Testing	315
Billing & Collection	456
Property Taxes	+ 298
Total Operating Expenses	<u>\$ 8,974</u>

¹² Application, Exhibit 10, Reference No. 6, Billing and Collection Costs.

¹³ \$1.50 (Billing and Collection Fee) x 25 (Customers) = \$38 x 12 Months = \$456.

¹⁴ Application, Exhibit 10, Reference No. 9, Corporate – State and Local Taxes.

REVENUE REQUIREMENTS

The Commission has historically used an operating ratio approach¹⁵ to determine revenue requirements for small, privately owned utilities.¹⁶ This approach is used because no basis for rate-of-return determination exists or the cost of the utility has fully or largely been recovered through the receipt of contributions. The Commission finds that this method should be used to determine Commonwealth's revenue requirements. The Commission finds that an operating ratio of 88 percent would allow Commonwealth sufficient revenues to cover its reasonable operating expenses and to provide for reasonable equity growth. An operating ratio of 88 percent results in a revenue requirement of \$10,474 as shown below:

Pro Forma Operating Expenses	\$ 8,974
Divided by: Operating Ratio	÷ 88%
Subtotal	<u>\$ 10,198</u>
Less: Pro Forma Operating Expenses	<u>- 8,974</u>
Net Operating Income After Income Taxes	\$ 1,224
Multiplied by: Gross-up Factor	<u>x 1.2254902</u>
Net Operating Income Before Income Taxes	\$ 1,500
Add: Pro Forma Operating Expenses	<u>+ 8,974</u>
Revenue Requirement	<u><u>\$ 10,474</u></u>

A monthly rate of \$34.92¹⁷ per customer will produce the revenue requirement determined reasonable herein of \$10,474. Since Commonwealth is a new system that does not have a full year of actual operations, it is difficult to accurately estimate or

¹⁵ Operating Ratio is defined as the ratio of expenses, including depreciation and taxes, to gross revenues.

$$\text{Operating Ratio} = \frac{\text{Operating Expenses} + \text{Depreciation} + \text{Taxes}}{\text{Other Than Income Taxes}} \div \text{Gross Revenues}$$

¹⁶ See, e.g., McKnight Utilities Co., Case No. 7553 (Ky. PSC Nov. 13, 1979).

¹⁷ \$10,474 (Revenue Requirement) ÷ 25 Customers ÷ 12 Months = \$34.9133.

project operating revenues and expenses. Given that Commonwealth has not begun providing service, the Commission is concerned that the rates granted may not provide an adequate surplus necessary to cover operating expenses and equity growth without owner contributions. Therefore, we find that, within 18 months of the date of this Order, Commonwealth should file an income statement, along with any pro forma adjustments, in sufficient detail to demonstrate that the rate approved herein is sufficient to meet its operating expenses and provide a reasonable return to Commonwealth's owner.

ACCESS FEE

Commonwealth includes in its proposed tariff an annual access fee of \$100 whose purpose "[i]s to insure that the lot owner pays some portion of the cost of the installation of the tap and contributes to the operation and maintenance of the treatment system."¹⁸ Commonwealth admits that it does not have supporting workpapers and "[t]he access fee is an estimate of the relative contribution needed to support the operation of the treatment facility."¹⁹

The Commission would allow a wastewater utility to charge an availability fee to such undeveloped lot in order to recover the fixed charges that will be incurred by the utility to have its service accessible. However, given that Commonwealth has not provided a basis for its proposed access fee and has not identified the costs that will be recovered by the fee, the Commission finds that the proposed annual access fee should be denied.

¹⁸ Commonwealth's Response to Item 18 of the AG's January 15, 2004 Request for Information.

¹⁹ Id.

NON-RECURRING CHARGES

Commonwealth requested Commission approval of the following non-recurring charges:

Non-Payment	5%
Reconnection Charge	\$ 25
Disconnection Charge	\$ 25
Returned Check Charge	\$ 25

Upon review of the proposed cost justification provided by Commonwealth in its application, the Commission finds that the non-recurring charges are reasonable.

SUMMARY

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

1. Commonwealth proposes to construct approximately 4,300 lineal feet of 4-inch and 3-inch PVC sewer mains, a recirculating media filter treatment plant, two subsurface drip dispersal fields, and related appurtenances to provide new sanitary sewer service to approximately 25 customers.

2. Plans and specifications for the proposed improvements prepared by Kentucky Wastewater Solutions, Inc. of Louisville, Kentucky, have been approved by the Groundwater Branch of the Environmental and Public Protection Cabinet and by the Environmental Management Branch of the Kentucky Department for Public Health.

3. The proposed construction will not serve areas that other sewer utilities presently serve.

4. The proposed construction will neither create wasteful duplication of plant, equipment, property or facilities nor result in uneconomic or wasteful competition between public utilities.

5. Public convenience and necessity require that the construction identified in Commonwealth's application be performed and that a Certificate be granted.

6. The customer will be responsible for the cost of installing the 1500-gallon interceptor tank, and the maintenance will be the responsibility of Commonwealth.

7. The monthly rate and access fee proposed by Commonwealth should be denied.

8. The rates and non-recurring charges set forth in Appendix A should be approved for service rendered on and after the date of this Order.

9. The provision requiring the installation of a shutoff valve contained in the proposed sewer subscription contract is not a reasonable condition of service and should not be approved.

IT IS THEREFORE ORDERED that:

1. Commonwealth is granted a Certificate to proceed with the proposed construction project as set forth in the plans and specifications of record herein.

2. Commonwealth shall obtain approval from the Commission prior to performing any additional construction not expressly authorized by this Order.

3. Any deviation from the construction approved shall be undertaken only with the prior approval of the Commission.

4. Commonwealth shall furnish documentation of the total costs of this project including the cost of construction and all other capitalized costs (engineering, legal, administrative, etc.) within 60 days of the date that construction is substantially completed. Construction costs should be classified into appropriate plant accounts in

accordance with the Uniform System of Accounts for Water Utilities prescribed by the Commission.

5. Commonwealth shall require construction to be inspected under the general supervision of a licensed professional engineer with a Kentucky registration in civil or mechanical engineering, to ensure that the construction work is done in accordance with the contract drawings and specifications and in conformance with the best practices of the construction trades involved in the project.

6. Commonwealth shall file a copy of the “as-built” drawings and a certified statement that the construction has been satisfactorily completed in accordance with the contract plans and specifications within 60 days of the substantial completion of the construction certificated herein.

7. Commonwealth shall notify the Commission one week prior to the actual start of construction and at the 50 percent completion point.

8. Commonwealth shall not require a sewer subscription contract that contains any requirement for the installation and use of a shutoff valve.

9. The monthly rate and access fee proposed by Commonwealth are denied.

10. The rates and non-recurring charges set forth in Appendix A, which is attached hereto and incorporated herein, are approved for service rendered on and after the date of this Order.

11. Commonwealth shall, within 18 months of the date of this Order, file an income statement, with any pro forma adjustments, reflecting one year of operations.

Done at Frankfort, Kentucky, this 3rd day of June, 2004.

By the Commission

ATTEST:

A handwritten signature in black ink, consisting of several overlapping loops and a long horizontal stroke at the bottom.

Executive Director

Case No. 2003-00431

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2003-00431 DATED June 3, 2004

The following rates and charges are prescribed for the customers in the area served by Commonwealth.

MONTHLY RATE

Residential Flat Rate	\$ 34.92
-----------------------	----------

NON-RECURRING CHARGES

Non-payment	5%
Reconnection Charge	\$ 25.00
Disconnection Charge	\$ 25.00
Returned Check Charge	\$ 25.00