

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF CLASSIC CONSTRUCTION,)
INC. FOR RATE ADJUSTMENT FOR SMALL) CASE NO.
UTILITIES PURSUANT TO 807 KAR 5:076) 2013-00258

ORDER

On July 2, 2013, Classic Construction, Inc. ("Classic Construction") filed an application with the Commission, pursuant to 807 KAR 5:076, requesting to increase its monthly flat sewer service rate from \$29.57 to \$45.00, an increase of \$15.43, or 52.18 percent. By this Order, the Commission approves a flat monthly rate of \$36.57, an increase of \$7.00, or 23.67 percent, to Classic Construction's current rate.

After reviewing Classic Construction's application and records, Commission Staff ("Staff") issued a report on October 31, 2013, containing Staff's findings regarding Classic Construction's proposed rate increase. After making numerous adjustments to Classic Construction's test-year operations, Staff found that Classic Construction's monthly rate should be increased to \$30.30.¹ Staff's adjustments included a \$9,423 reduction to test-year operating expenses for expenditures that Classic Construction failed to adequately document.²

In its November 26, 2013 response to the Staff Report, Classic Construction provided additional documentation to support many of the expenses disallowed by Staff.

¹ Staff Report at 3.

² *Id.* at 9 and Attachment B.

Staff prepared exhibits containing financial information based on the additional documentation provided by Classic Construction. The financial exhibits were discussed during the informal conference held on December 4, 2013. Classic Construction, Staff, and the Attorney General of Kentucky (“AG”)³ participated in the informal conference.

Staff prepared, and entered into the record on December 6, 2013, a memorandum summarizing the discussions held during the informal conference. The exhibits discussed during the informal conference were attached to the memorandum. The exhibits demonstrate that Classic Construction’s monthly rate should be increased to \$36.57.

On December 16, 2013, the AG filed notice that he did not object to the financial exhibits attached to the conference memorandum or the \$36.57 monthly rate. The AG did not seek a hearing and requested submission of the matter for decision. On January 14, 2014, Classic Construction waived a formal hearing and requested that the case stand submitted to the Commission.

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

1. Classic Construction, a Kentucky corporation, owns and operates sewage treatment and collection facilities that serve approximately 107 residential customers in the Ridgewood Subdivision and the Circle Subdivision located in Franklin County, Kentucky.⁴

³ On August 14, 2013, the Commission granted the AG’s motion for intervention.

⁴ Staff Report at 1.

2. The calendar year ending December 31, 2012, should be used as the test year to determine the reasonableness of Classic Construction's existing and proposed rates.

3. Given that no basis exists to determine an appropriate rate of return for Classic Construction, use of an operating ratio⁵ is appropriate to determine its allowable Net Operating Income ("NOI").⁶

4. The Commission's historic method of applying an operating ratio provides Classic Construction with an allowable NOI of \$5,824.⁷

5. Classic Construction's adjusted operating statement shows operating revenues of \$46,961 are required to produce the allowable NOI, as set forth in Appendix A of this Order.

⁵ Operating Ratio is defined as the ratio of expenses, including depreciation and taxes, to gross revenues. It is illustrated by the following equation:

$$\text{Operating Ratio} = \frac{\text{Operation \& Maintenance Expenses} + \text{Depreciation} + \text{Taxes}}{\text{Gross Revenues}}$$

⁶ See, e.g., Case No 8468, *An Adjustment of the Rates of Plantation Hill Sewage Treatment Plant, Inc.* (Ky. PSC Jun. 25, 1982); 1 A.J G. Priest, *Principles of Public Utility Regulation* (Michie 1969) 220-224.

⁷

Operating Expenses Before Income Taxes	\$ 40,962
Divide by: 88 Percent	<u>0.88</u>
Sub-Total	46,548
Less: Operating Expenses Before Income Taxes	<u>(40,962)</u>
Subtotal	5,586
Plus: Interest Expense	<u>238</u>
NOI Allowed	<u>\$ 5,824</u>

6. Classic Construction's proposed rate will produce annual operating revenues in excess of \$46,961 and should be denied.

7. A flat monthly sewer service rate of \$36.57 is necessary to produce the required revenues.⁸

8. The operating ratio resulting from the required operating revenue is 87.60 percent.⁹

9. The account balances reported in Classic Construction's 2012 Balance Sheet for Utility Plant in Service, Other Deferred Debits, Miscellaneous Operating Reserves, Accumulated Depreciation, Other Current Assets, Retained Earnings, and Contributions-in-Aid-of-Construction are materially misstated as a result of prior period accounting errors.¹⁰

10. Classic Construction should correct the account balances for all misstated accounts prior to submitting its 2013 Annual Financial and Statistical Report to the

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Required Revenue	\$ 46,961
Divide by: Number of Customers	107
12 Months	<u>12</u>
Monthly Rate	<u>\$ 36.57</u>

9

Operating Expenses	\$ 41,137
Divide by: Operating Revenues	<u>46,961</u>
Operating Ratio	<u>87.60%</u>

¹⁰ Staff Report at 4-5.

Commission. Classic Construction should not amend and re-file financial statements submitted to the Commission in prior periods.

11. Classic Construction calculated test-year depreciation expense on a fence using the double declining method. In all future reporting periods, Classic Construction should report depreciation expense on this asset, and all other assets, using the straight line method as required by the Uniform System of Accounts.¹¹

IT IS THEREFORE ORDERED that:

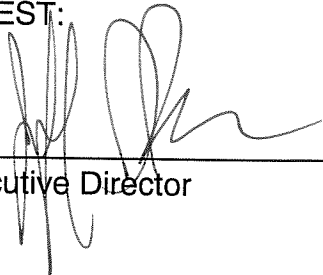
1. The rate proposed in Classic Construction's Application is denied.
2. The rate shown in Appendix B is approved for sewer service rendered on and after the date of this Order.
3. Within 20 days of the date of this Order, Classic Construction shall file revised tariff sheets with the Commission, using the Commission's electronic Tariff Filing System, containing the rate set forth in Appendix B to this Order.
4. Classic Construction shall properly report the account balances for Utility Plant in Service, Other Deferred Debits, Miscellaneous Operating Reserves, Accumulated Depreciation, Other Current Assets, Retained Earnings, and Contributions-in-Aid-of-Construction in its 2013 Annual Financial and Statistical Report that it files with the Commission.
5. In all future reporting periods, Classic Construction shall depreciate its assets using the straight-line method. No retroactive adjustment to accumulated depreciation or retained earnings shall be made to account for this change in accounting method.

¹¹ *Id.* at 17.

By the Commission

ENTERED
MAR 06 2014
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:



Executive Director

Case No. 2013-00258

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2013-00258 DATED **MAR 06 2014**

Classic Construction, Inc.'s Adjusted Operating Statement

Operating Revenues - Sewer Service Revenue	<u>\$ 46,961</u>
Operating Expenses	
Operation and Maintenance	
Owner/Manager Fee	3,600
Collection System	12,000
Treatment System - Sludge Hauling	2,605
Treatment System - Water Cost	304
Fuel and Power	4,707
Chemicals	284
Routine Maintenance Fees	3,324
Maintenance of Pumping System	205
Maintenance of Treatment and Disposal Plant	2,290
Agency Collection Fee	5,398
Office Supplies and Other Expenses	534
Outside Services Employed	<u>300</u>
Total Operation and Maintenance Expense	35,551
Amortization	1,040
Depreciation	2,295
Taxes Other Than Income	2,076
Income Taxes, Limited Liability Entity Tax	<u>175</u>
Total Operating Expenses	<u>41,137</u>
Net Operating Income	<u>\$ 5,824</u>

APPENDIX B
APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2013-00258 DATED **MAR 06 2014**

The following rate is prescribed for the customers in the area served by Classic Construction, Inc. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

Monthly Sewer Rates

\$36.57 per residential equivalent

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