

COMMONWEALTH OF KENTUCKY
BEFORE THE UTILITY REGULATORY COMMISSION

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In the Matter of:

APPLICATION OF RED WING UTILITY COMPANY,)
INC., FOR AN INCREASE IN RATES FOR THE)
SEWERAGE TREATMENT FACILITIES LOCATED IN:)
GATEWAY SUBDIVISION, MARSHALL COUNTY;)
GOLDEN ACRES SUBDIVISION, MARSHALL COUNTY;) CASE NO. 7568
BLANDVILLE ESTATES, MCCRACKEN COUNTY;)
GREEN ACRES SUBDIVISION, MCCRACKEN COUNTY;)
FIELDMONT ESTATES, MCCRACKEN COUNTY;)
HOLIFIELD ESTATES, GRAVES COUNTY)

On September 5, 1979, Red Wing Utility Company filed an Application with this Commission seeking authority to increase its rates for sewage treatment in the Gateway, Golden Acres, Blandville, Green Acres, Fieldmont, and Holifield Estates Subdivisions. Hearings were held at the Commission's offices at Frankfort, on November 27, 1979 and August 4, 1980. In order to provide the customers of this utility with an opportunity to be heard, a further hearing was held in this matter on September 10, 1980. Throughout the course of these hearings, the Company has responded to various written and oral requests for information from the Commission staff, Attorney General and other intervenors in the case.

The Commission suspended the proposed rates from May 1, 1980 to July 5, 1980. By letter dated July 9, 1980, the Company through counsel waived its right under KRS 278.190 to place the proposed rates into effect.

In its petition, the Company seeks a flat rate for all residential customers or their equivalent of \$38.00 per month. For the affected customers, this compares to rates currently being charged by Red Wing of \$8 to \$10 per month per residential equivalent.

In support of its requested increase, the Company filed a comparative income statement showing the recorded results for the test year, adjustments to the test year and the adjusted test year results.

At the first hearing in Frankfort on November 29, 1979, the Commission heard arguments on the Attorney General and Intervenor's Motion to Dismiss and the Company's response to those Motions. Certain petitions and depositions were also filed by the Intervenors at this hearing. By Order dated April 21, 1980, the Commission overruled the Attorney General's Motion to Dismiss due to lack of technical compliance with the time requirements related to the time span from the end of the test year to the date of filing of the application. This Order further required Red Wing to furnish additional information and deferred ruling on the remainder of the Attorney General's and the Intervenor's motions not addressed by the Order.

At the August 4, 1980 hearing the Company presented as its witnesses Richard C. Boyd, CPA and Jerry Veach, Vice President of Red Wing Utility.

In his direct testimony, Mr. Boyd testified that he was familiar with the financial reports and condition of the Company. He further testified that based on recorded per books data, the rate the Company would require for an operating ratio of .88 would be \$42.69 per month; that based on financial reports, the Company for 1979 had a \$86,147.31 loss and for the first six months of 1980, the loss was \$44,909.52. On cross, he testified that he had discussed allocation of expenses among several of the subdivisions and that he and Mr. Veach had agreed on a basis for allocation, but that Mr. Veach had prepared the documents submitted in the case. Mr. Boyd further testified that he had not advised Mr. Veach on depreciation; that he did not know how the estimated original cost of the property was determined for certain treatment plants; that he had not checked to see if the five-year life on the excavator fell within the useful life guidelines of the IRS; that he thought the Company had employed an accountant in prior years; that he had been the accountant for Red Wing since the first of the year; that he had not performed an audit of the Company; and that he did not know whether the excavator was used in any business other than the utility's business.

On direct examination, Mr. Veach testified that contributed property was first assigned to property having a ten-year life; that the effect of this was to reduce depreciation on this property; that the original cost was estimated where a system was purchased from a developer and the developer's original cost was not known, but did not explain the methodology for estimating these costs; that the Company's accountant prior to Mr. Boyd was Thomas Smith of Calvert City and that Mr. Smith had established the depreciation schedule; and that Red Wing was being subsidized by Veach Plumbing.

On cross examination, Mr. Veach testified that he was Vice President of Red Wing Utility; that \$7,100 had been received as contributions from Golden Acres Subdivision; that \$275,479 of \$467,195 total construction costs was actually received as contributions in aid of construction, as shown on Pages 2 and 3 of the information provided in response to the Commission's request; that projections of additional customers were based on average billings for the last four years or discussions with developers; that five homes in Holifield Heights currently on septic tanks could not be added because they are outside the collection system; that \$6,000 was included as management fee for Mr. Emmett Veach as Supervisor and Manager of the Company; that \$13,370 for labor and expenses was paid primarily to Jerry Veach and his father as operators of the system; that these fees are paid on an annual basis; that his mother, Mrs. Veach, was paid approximately \$340 per month for doing the billing and journal posting; that Red Wing was paying \$750 per year for office rental to Veach Plumbing; that the excavator had been purchased because at that time it was used to construct collection systems and treatment plants; that in his opinion, the cost of the excavator was more than offset by the savings in constructing the plant; that the excavator was purchased in February, 1977; that the excavator had been used to construct systems in Fieldmont and Highland Club Estates and expand three other systems; that the excavator was

rented to other contractors with or without an operator; that \$6,334 had been recorded as administrative salary for Jerry Veach; that the relationship between Gateway Village Development and Red Wing is that Mr. Emmett Veach owns both Companies; that the sewer system in the Gateway Subdivision was purchased from Gateway Utility Corporation and Gateway Development Corporation; that no relationship exists between the owners of Red Wing and these two corporations; that Note 43-42 was made to secure financing of expansion of Blandville West Estates; that Note 49-23 was secured for construction of collection systems and treatment plants in undeveloped subdivisions and expansion of existing subdivisions; that the cost of constructing Blandville West Estates was \$102,087 including the Ree-L Subdivision; that total contributions received from these subdivisions were \$71,500; that construction plans were drawn up by an engineer for these subdivisions, but Red Wing did not require the engineer to provide estimates of the cost of constructing this expansion; that he did not know what employees were involved in constructing the system in these subdivisions; that the \$71,500 reported as contributions have not all been paid by the developers of these subdivisions; that tap fees collected were used to pay the Company's cost of operation in lieu of paying off the loan; that in Fieldmont Estates, \$78,000 in tap fees has been recorded as contributions even though all taps have not been collected; that uncollected taps are being reported as notes receivable; that in Green Acres, contributions of \$75,400 in the form of tap fees have all been collected; that if an independent contractor with an excavator had been hired to put in the two sewer systems it would have cost as much to do one subdivision as it did to do two subdivisions with the company-owned excavator; that at this time Red Wing has no plans for construction of additional treatment plants or collection systems; that the excavator will be used for occasional maintenance which would not necessarily substantiate keeping the excavator; that the Green Acres treatment facility and

system design would accommodate a population equivalent of 340, which is equivalent to 85 homes; that a possibility of four more customers in Green Acres exists; that Roland Estates, a subdivision with 28 lots, is adjacent to Green Acres; that the number of customers can fluctuate above or below design capacity of 85 homes; that the number of customers to be added from Roland Estates has been approved by the State Division of Water Quality; and that the Blandville West treatment plant had to be expanded to add Ree-L's customers.

Mr. T. W. Rodgers, Secretary of Rowland Estates, Inc., offered testimony concerning his dealings with Red Wing Utility. He testified that Red Wing had been paid \$5,416 by Rowland Estates, Inc. to help defray cost of the treatment plant and that Rowland donated the land the Blandville West plant was built on and granted free easements; that after formation of Rowland Estates, the Company was paid \$8,550 in September, 1975, as tap fees for 9 lots; and in April, 1979, \$15,200 was contributed to pay for increasing the capacity up to a level sufficient to serve Green Acres plus 28 lots in Rowland Estates.

Mr. Clyde Holifield presented testimony at this hearing. He testified that he was not opposed to rates in the range of \$12 to \$15 per month; that currently in his subdivision there are five houses and one double-wide trailer; that the possibility exists for 18 more customers; that houses in his subdivision would sell for from \$26,500 to \$30,000; that a rate of \$12 to \$15 per month is based on what he understands will be the rate for a large sewage system in the planning stages at Sedalia; and that five houses in Rowland Estates are actually hooked up but 18 more could be added.

The third hearing in this matter was held at Kentucky Dam Village, Gilbertsville, Kentucky. Several of the Company's customers and several of the developers in the Company's service area appeared at the hearing to testify on this matter.

The following testimony and evidence were presented at that hearing:

Mr. Albert H. Arrant, a customer living in the Green Acres Subdivision urged the Commission to consider the fact that Veach Plumbing and Red Wing Utility were owned by the same stockholders and the operations were commingled; that the utility had purchased an excavator which Mr. Arrant thought was unreasonable; that if the Commission did fix rates, to set them separately so that Green Acres would not be forced to subsidize other less-developed subdivisions; and that the Commission give consideration to the third party beneficiary agreement.

Mr. T. W. Rodgers, Secretary of Rowland Estates, Inc., testified that a rate of \$38.00 per month would absolutely stop the sale of any property in Rowland Estates, and that sufficient funds had been paid to Red Wing to provide sewage to his property.

Martha Walsh, a customer in Green Acres testified that she thought Green Acres should be self-sufficient since the subdivision is almost completely developed.

Barbara Rankin testified concerning the difficulty she had in obtaining service in 1976 and that she could never get Red Wing Utility to come back after the service was provided and fill up holes caused by the construction.

Mr. Robert French, a customer in Golden Acres, testified that a \$38.00 rate would hinder development in the subdivision and related the fact that another customer had to remain on the system and continue paying a monthly sewer bill even though he was not using the sanitary facilities due to a fire. According to Mr. French, the customer's only alternative was to disconnect service and pay a hook-up fee of \$800 when service was reinstated.

Lorraine Kimbrell, a developer of Blandville West Estates, testified that it was unreasonable to raise sewer rates when a subdivision was only half completed; that the subdivision would remain half completed if the increase requested

was granted; that while not certain, it was her opinion that the requested increase was a major reason that no lots had been sold since the increase was requested; that as a part of the agreement with Red Wing, entered in 1976, the developer provided a lot for the treatment plant; that within 30 days the existing 19 customers would pay \$700 tap fee or if paid after 30 days, the fee would be \$1200; that Red Wing agreed to provide service for remaining lots for \$36,400 to be paid \$7,000 the first year, \$10,500 the second year and \$7,000 in the third and subsequent years until the \$36,500 was paid; that except for one lot all fees had been paid; that this increase will cause the subdivision to die on the vine; that she had not seen the excavator used in Blandville West; that Veach's backhoe sat for two years in the same spot; that currently there are 52 building lots in Blandville West on which tap fees have been paid by her; and that total contributions in the form of tap fees would approximate \$71,500.

Erin Court, CPA, testified on behalf of the Intervenors from Blandville West and Gateway Subidivision. Mr. Court testified that from his review of the data he had concluded that the investment in Gateway Subdivision was either contributed by lot owners or financed by borrowed funds and that for this reason Red Wing had a negative investment and was due no profit until enough fees could be generated to pay off the note; that the numbers had not been audited by the witness; that \$4,300 for labor to operate Gateway seemed large to the witness; that the capital allocated to Blandville West of \$150,390 is \$48,303 greater than the \$102,087 shown as the cost of the assets in the depreciation schedule; that some of the salaries charged to expense may be more properly capitalized; that he would be curious to know why an excavator was needed for these operating systems; and that he is part owner in Gateway Lanes Bowling Alley.

On cross he testified that major adjustments made in prior years seemed to bring the accounting system into compliance with generally accepted accounting principles except for the question of under-capitalization of wages; that if the Company

was accruing salaries on the books but paying payroll taxes on the basis of cash payroll and that this factor could explain why payroll taxes had not been paid.

Victor Powell, Vice President of the Bank of Benton, testified that a rate increase of the magnitude requested would be detrimental to Gateway and the area surrounding it; that sales of homes would be affected and maybe even commercial properties; that property values would have to decrease to some extent; and that the requested increase would greatly stymie future development of Gateway.

Jimmy Wammack, a homebuilder and contractor at Drafenville, testified that he had two apartments and a home in the Gateway Subdivision; that he was not planning any further development in Gateway because of the rate increase.

Betty Haley, Executive Director for the Marshall County Chamber of Commerce, testified that in her capacity she had observed the development of the Gateway Subdivision; that the requested increase would stop residential and especially business development in the area; that Red Wing bills in advance and charges penalty for late payment; that the business rate will be \$114 per month if the requested rates are approved; that the development in this area should not be halted so that Red Wing can expand or some other subdivision can be developed; that while the Chamber of Commerce only pays \$15 per month, other businesses pay \$30, \$20, and in case of certain apartments \$10 per month; and that one customer, a Mr. Washburn, had to continue paying a \$25 a month sewage bill during a six months period when the service station was out of business due to a fire.

Mr. R. L. Nimmo, a developer of the Ree-L Estates, testified that he was subpoenaed; that in 1976 he had entered into an agreement with Mr. Veach for Red Wing to extend service to Ree-L Estates; that Ree-L Estates contains 22 lots and is located west of Blandville West; that \$18,050.00 was paid for

19 taps at \$950.00 per tap; that Mr. Veach had been paid the money for these taps a year before service was finally installed; that no houses have been built to date; and that \$38 per month for sewer service would probably cause people to have second thoughts about locating in Ree-L Estates.

Mr. Troy Truitt, President of the First Liberty Bank in Calvert City, testified that the bank had serviced a loan to Red Wing which was guaranteed 90% by the Small Business Administration (SBA); that as of August 18, SBA had purchased 90% of the loan from the bank; that the original amount of the loan was \$260,000.00; that 10% of the outstanding loan balance is still owed to the First Liberty Bank which amounts to \$25,133.77; that he did not know Commission approval of the loan was required; that the bank's portion of the loan has been charged off and that at the present time no steps have been taken to collect the 10% owed First Liberty but that the bank will work with SBA on collection; that the original loan was made on March 23, 1977; that the proceeds from the \$260,000 loan were to be used to purchase (1) three parcels of land for \$15,000; (2) three sewage treatment plants for \$133,000; (3) a Case 880 Excavator, a Dodge truck, and a Dodge one-ton flat bed truck for \$57,000; (4) retire two Bank of Benton notes for \$35,000; (5) operating expenses of the business, \$20,000; that the loan was secured by the three parcels of land, the equipment purchase, and second mortgages on real estate; that a note with face amount of \$30,000 with a balance due of \$27,000 was held by First Liberty and was separate from the \$260,000 loan; that he did not know whether the Bank of Benton notes were created by debts from operation of the sewage system or were some unrelated business debt; that to his knowledge none of the proceeds from the \$260,000 loan were used to pay off a \$13,228.80 debt owed to Clyde Holifield; that approximately four of these projects were covered by a third party beneficiary agreement; and that if Red Wing Utility became insolvent the bank, together with SBA, would have to take over these systems.

Mr. Joe Wamble, a customer in the Blandville West Estates testified that he was retired; that the increase requested was outrageous; that people in Blandville West cannot afford to pay that kind of rate; that as a result of the rate increase proposal the price of real estate has been lowered; that the excavator had been idle for approximately a year, just sitting on a vacant lot in Blandville West.

Clyde Holifield, developer of Holifield Heights Subdivision, testified that Red Wing operated a sewage treatment facility in that subdivision; that six homes were currently on the system; that he had funded the construction of the system; that he loaned \$12,500 to Red Wing for the purpose of building the treatment plant and the collection system; that to his knowledge he was paid out of the SBA loan proceeds by the Company's attorney; that Red Wing or its representatives had never indicated the system cost \$28,000; that the rate agreed to was \$8.00 per month; that Red Wing had refused new customer hook-ups and Red Wing had caused the system to shut down by pouring concrete in the mains; that the system had stopped up, one of the customers had unstopped it and received a bill from Red Wing for unstopping the line; that the Graves County Health Department frequently had to shut the treatment plant down for a period of two weeks, once for six weeks; that houses built in that subdivision would be worth \$25,000 to \$30,000; that current home owners have indicated that they will try to sell and move if the \$38 per month rate is approved; and that he did not know mains were filled with concrete due to nonpayment of monthly charges until after the sewage plant was closed.

Robert Woodsmall, a developer of Highland Club Estates, testified that the developers agreed to put in the system and give it to Red Wing; that a rate of \$12 per month was agreed on; that the subdivision was 100% residential; that the system

was rated to handle 35 lots and currently eight houses were receiving service; that to his knowledge all construction costs of the Highland Club system was paid by Highland Club; that there was never any mention of an additional \$7,560 being required for the system; that a lift station had not been put in and damage had resulted; that Highland Club had to remove waste, i.e., trees and other debris from construction of the treatment plant; that the treatment plant had not been landscaped; that the contract to install the treatment plant at Highland Club Estates was signed in May of 1978; that work began in September, 1978; that the treatment plant was in operation in December '79; that the contract for construction was with Veach Plumbing; that \$13,000 was invoiced to Highland Club as pipe, but only \$6,000 to \$6,500 was used in Highland Club with the other \$7,000 of pipe being used in another subdivision; and that houses in that subdivision were priced from \$60,000 to \$175,000.

Mr. Reid Hearn, a resident of Highland Club Estates, testified that he moved into his present residence in December, 1979; that the system was connected, but not functioning; that sewage on the ground caused a cave-in three feet wide and 100 feet long and damaged his driveway.

Mr. Jerry Featherstone, Administrator of the Graves County Health Department, testified that he had received numerous complaints regarding the service provided by Red Wing and had made numerous trips to Holifield Heights and Highland Club Estates Subdivisions; that the customers of Holifield Heights had encountered health hazards when their system was backed up or turned off; that at Highland Club Estates the lift station seemed to break every two to three weeks; that a necessary lift station was not installed; and that complaints had been received from the country club served by Red Wing.

Mr. Jerry Veach, Vice President of Red Wing, was cross examined further at this hearing and testified that he was not aware Commission approval was required for the \$260,000 note; that he would provide evidence that Red Wing purchased the treatment plant installed at Golden Acres; that the excavator is rented for \$45 per hour when there is a renter; that he is Vice President of Veach Plumbing Company; that the excavator is used extensively in the plumbing business; that he had not drawn any salary from Red Wing, it was all accrued; that he does some maintenance, some testing and some book work; that he averaged better than twenty hours per week for Red Wing; that it was all bookkeeping in the early part of the year and all maintenance in the winter months; that his mother did about 20 hours per week bookkeeping work; that his dad did mostly operation and maintenance work and spent about thirty hours a week or better on Red Wing; that the maintenance man was no longer employed; that the notes owed the Bank of Benton, which were paid off from the proceeds of the \$260,000 loan, arose from the purchase of the Golden Acres Subdivision for \$17,225.35 and the Gateway treatment facilities for \$20,023.28; that the funds provided by Mr. Holifield for the system at Holifield Heights was only partial financing; and that if the increase is granted there will be no further development in these subdivisions.

This case presents some difficult and perplexing problems for this Commission. The quality of the financial and accounting data presented in this case leaves much to be desired. The Company presented the testimony of its CPA. However, this witness' testimony was of little value since the witness was basically unfamiliar with the Company's operations and had not audited the Company's records. In short, it appears that the services provided by the CPA only amounted to advising Red Wing on ways of allocating costs to the several of the subdivisions. The Intervenors from Blandville West and Gateway Subdivisions presented a CPA whose analysis was limited to data filed by the Company. Consequently, this witness raised many questions but offered few answers.

After reviewing the condition of Red Wing's financial records, the Attorney General did not believe it would be possible for the Commission to set a fair rate. In fixing a reasonable rate, the Commission must examine actual test year experience and study it to determine the reliableness of that experience as an indication of what a reasonable charge for a particular operating expense might be and what a reasonable provision for operating revenues might be.¹ The Commission questions the reliableness of the financial data presented. First, it appears that the funds of Veach Plumbing and Red Wing Utility have been commingled to some extent and the basis for allocating operating expenses common to both Red Wing and Veach Plumbing is questionable. "[C]osts inflated by improper charges or injudicious expenditures are not conclusive and mere actuality of expense does not establish its 'reasonableness . . . propriety or necessity.'"² Second, the Company never satisfactorily answered the question of whether or not it was properly capitalizing wages of employees engaged in construction. Third, the Company has over the past several years either accrued or paid fees for accounting services to its owners and outside accountants but was not in this docket able to present clearly the operating costs of Red Wing Utility, particularly as they related to transactions between the Company and Veach Plumbing. It is a well-settled regulatory principle that waste is chargeable to a utility's stockholders, not its customers.³ The Commission has also noted that Veach Plumbing and Red Wing have the same owners.

The Commission believes under competent and dedicated management the above accounting problems could be overcome. However, the Commission believes that serious errors in the

¹Re Terryville Water Company, Connecticut Public Utilities Commission, Docket No. 8606 (1952).

²New England Telephone and Telegraph Company V. State of New Hampshire, 95 NY 35378 PUR NS 67,78,64 A2d 9 (1949).

³Consumers Power Company 14 PUR 4th 1, 43 (1976).

financial management and expansion of the system have created a situation wherein the ability of the Company to continue as a viable economic entity able to provide service at reasonable rates is virtually non-existent. This is most clearly evident from the Company's request to increase its rates from \$8.00 to \$38.00 per month. "A utility must be efficiently and economically managed and operated as a condition to the exercise of its right to impose rates adequate to cover the full cost of service."⁴ In reaching the conclusion that Red Wing is currently unable to provide adequate service for reasonable rates, the Commission has considered the problems which have brought this Company to the brink of insolvency. The first problem is one of expanding service to new areas without regard to the ability of the Company to maintain its financial integrity. For example, Company witness Jerry Veach testified that engineering plans for the system were drawn up but that the engineer was not required to provide cost estimates for proposed expansion. Without the cost estimates, management could not determine whether the expansion was feasible and should be undertaken. Therefore, management abdicated its role and displayed a recklessness which can only be characterized as imprudence. In a small company such as Red Wing, this type planning is critical to its economic survival.

Secondly, it is apparent that the Company did not comply with KRS 278,020, KRS 278.300 and Commission regulations which clearly require sewage utilities to apply to the Commission for a certificate of convenience and necessity authorizing new construction and approval of new debt and equity financings of utilities. Thus, the Company, with the backing of the Small Business Administration, borrowed \$260,000 from the First Liberty Bank in Calvert City to, among other things, expand its existing system, build three treatment plants, buy an excavator for the utility and pay off several outstanding notes. Although when Red Wing applied for the loan they explained they would spend \$15,000 to acquire three (3) parcels of land, the

⁴ Id., 38.

information Red Wing supplied the Commission does not indicate any funds were spent for that purpose. In addition, it appears that \$15,000 - \$20,000 was spent on "operating expenses", but Red Wing did not explain which expenses were paid with the funds borrowed.

"It is reasonable to conclude that the Company's complete disregard for the eventual financial consequences was to its belief that any costs incurred could be passed along to the customer, without regulatory scrutiny."⁵ The Commission has considered the circumstances surrounding the purchase of the excavator. The Company witness states that with the excavator, it could construct two systems for the same price it would cost to construct one system by contract. However, no comparison or study of the cost under the two methods was provided to support this statement of the witness. Numerous customers of the utility testified that from their observation, the excavator was idle more than it was in use. Red Wing's consumers cannot be expected to pay a rate which includes the cost of any facility which has not been actually used for the production of service to those consumers.⁶ Additionally, Mr. Veach does not expect any significant growth that would justify this piece of equipment prospectively. It should be noted that the Commission has a duty to a utility's ratepayers to prevent a utility from passing on the unreasonable costs of materials and supplies.⁷ The Commission believes this type of financial management, which apparently gave no regard to the impact on the rates of existing and future customers of expanding its service area and purchasing equipment such as the excavator, is simply irresponsible. Unwise expansion might have been averted if the Company had properly sought certification of the new construction whereby the Commission would have had the opportunity to evaluate the new indebtedness proposed by Red Wing.

⁵Id., 39.

⁶Gulf States Utility Company V. Louisiana Public Service Commission, 364 So 2d 1266 (1978).

⁷In re. Lakewood Water and Power Company, 21 PUR 3d 103, 105 (1957).

The Company's management has not sought to promote any type of reasonable public relations with its customers. There are two cases which clearly demonstrate this point. When the customers in Holifield Estates refused to pay their bills, instead of pursuing appropriate legal remedies to collect the fees or disconnecting the service tap, the Company apparently proceeded to pour the mains full of concrete. This is exactly the type of abuse the Supreme Court intended to eliminate when the Court determined that, "A public utility will not be permitted to include negligent or wasteful losses among its operating charges."⁸ Another example of Red Wing's poor management was the Company's failure to install a lift station which it knew was required to service a Mr. Hearn in Highland Club Estates. Thus, the Company has unreasonably and imprudently added to its costs, thereby weakening the Company's financial condition and contributing to its losses. If the financial data were acceptable the Commission would be justified in determining lower rates than those supported by the data to be reasonable because of Red Wing's chronic poor service.⁹ In 1952, the Kentucky high court decided that the question of whether to assess a penalty rate against a public utility for providing inadequate service was essentially a question of regulatory policy within the discretion of the Commission.¹⁰ The fact that KRS Chapter 278 provides for utilities to charge reasonable rates does not compel this Commission to grant a rate increase where the Applicant's existing service is shown to be inefficient.¹¹

The final consideration is one of the future of this Company and its customers. "The fixing of just and reasonable rates involves a balancing of investor and consumer interests."¹²

⁸West Ohio Gas Company V. Public Utilities Commission of Ohio, 294 US 63, 55 Sct 316, 79 Led 761,767 (1935).

⁹Arlington Selectmen V. Arlington Water Company, 394 A2d 1130 (1978).

¹⁰City of Lexington V. Public Service Commission of Kentucky, 249 S.W.2d 760 (1952).

¹¹North Florida Water Company V. Bevis, 7 PUR 4th 414,415,302 So 2d 129 (1974).

¹²Re. Montana Power Company 1 PUR 3d 167,181 (1953).

Sewage rates should be based not only on the cost to serve, but also the value of service, historical rates, customer use characteristics and economic factors. It is obvious that even if the accounting and financial data were reliable, approval of a rate increase of this magnitude would halt the growth in the Company's service area. "Rates paid to both the utility and its patrons cannot be reached solely by consideration of factors numerically expressed. Such factors must be viewed with a perspective gained by perception of their interrelation and perception of other factors which cannot be given precise mathematical expression."¹³ We, therefore acknowledge the fact that if the Company is going to survive then growth must be realized. After all, the systems were sized to serve the subdivisions after full development and such system will be the most economical to run when utilized completely.

The subdivisions currently served by the Company for which this increase is being requested are Gateway, Golden Acres, Blandville Estates, Green Acres, Fieldmont Estates and Holifield Estates. The capacity of the plants serving each of these subdivisions and the number of customers served by each plant are as follows:

	<u>Capacity</u>	<u>Existing Customers</u>
Gateway	51	49
Golden Acres	62	34
Blandville Estates	75	52
Green Acres	85	78
Fieldmont Estates	75	15
Holifield Estates	15	6

The Company, the customers served, and the developers in the area all acknowledge that a rate of \$38 per month will halt all growth and insure the continued under-utilization of the treatment plants in Blandville Estates, Golden Acres, Fieldmont and Holifield Estates.

The Commission, after consideration of all the evidence of record and being advised, is of the opinion and FINDS:

¹³ Pennsylvania Public Utilities Commission V. Equitable Gas Company, 60 PUR NS 99,100 (1945).

1. That Red Wing has failed to prove that the increased rates proposed are just and reasonable.
2. That approval of the rate requested would effectively eliminate future growth in the Company's service area, and promote the continued under-utilization of the existing treatment plants and collection systems.
3. That current management has demonstrated it is not capable of operating the Company in an efficient, prudent and reasonable manner.
4. That the third party beneficiary agreement should be invoked because of the recurring and prolonged service problems, including lengthy shutdowns of the treatment plants lasting two to six weeks.
5. That the operation of the Company should be placed in the hands of the Representative, First Liberty Bank of Calvert City, until a receiver can be appointed.
6. That the Representative should begin immediately to oversee the operation of the Company and seek a competent operator for the system.
7. That the Representative should immediately establish a system of accounting which clearly separates the costs of operating the sewer systems from the operation of Veach Plumbing Company.
8. Having rejected the financial data furnished by Red Wing because it is unreliable and incomplete, the best information available to the Commission regarding fair, just and reasonable rates are the rates which have been approved in recent cases for similarly-sized companies located in close proximity to Red Wing. A compilation of this information is contained in Appendix A. Based on this information, the Commission finds a rate of \$15.00 per month per residential customer or residential equivalent to be reasonable. We believe this action is consistent with the line of Supreme Court decisions beginning with Federal Power Commission v. Hope Natural Gas Company, 320 US 591, 88 Led 333, 64 S Ct 281 (1944), which have held that it is the end result of a rate,

not the methodology used, which governs whether the rate set is reasonable.

9. That the Company engage in no further expansion of any of its systems without prior approval of this Commission.

10. That the various rate agreements referred to by developers and customers at the hearings do not bind this Commission in its function of setting just and reasonable rates. Midland Realty Company v. Kansas City Power and Light Company, 300 U.S. 109 (1936); Fern Lake Company v. Public Service Commission, 367 SW 2d 701 (1962).

11. That the purchase of the excavator was not prudent nor reasonable and that costs associated with this equipment have not been considered as a part of existing rates and should not be considered as a part of any future rates of this Company.

12. That when any transaction of this Company is entered into with a related company or family member, the transaction is suspect. Red Wing did not produce any records or information supporting the proposition that transactions between the inter-related companies and owners were made at arm's length. Therefore, in the future the Company shall obtain and retain sufficient information to document the reasonableness of any such transactions.

13. That this Order shall serve as notice to both the Company and the Representative, First Liberty Bank of Calvert City, that the Commission has invoked the Third Party Beneficiary Agreement which provides for the Representative to take immediate possession of the sewerage system when the Company has defaulted in operating and maintaining it and for the Commission to seek the appointment of a receiver.

Based upon the above-stated findings, it is therefore ORDERED that the proposed Schedule of Rates as set forth in the Company's Application of September 5, 1979, be and the same are hereby denied.

It is FURTHER ORDERED that effective with the date of this Order, Red Wing Utility Company is hereby authorized to place in effect the schedule of rates as set out in Appendix B, attached hereto.

It is FURTHER ORDERED that within twenty (20) days of the date of this Order, the Company through its Representative shall file its tariff sheets setting forth the rates approved herein. Further, that copies of all rules and regulations of the Company for providing service to customers located in the various subdivisions in Graves, McCracken and Marshall County shall be filed with said tariff sheets.

It is FURTHER ORDERED that the First Liberty Bank of Calvert City shall immediately take possession of the sewerage systems contained in Blandville West, Holifield Estates, Green Acres, Golden Acres, Gateway and Fieldmont Estates subdivisions, as provided in the Third Party Beneficiary Agreement.

It is FURTHER ORDERED that the Representative shall provide monthly reports to the Commission showing all revenues collected and expenditures made on behalf of Red Wing Utility Company. Details shall be maintained for all expenditures.

It is FURTHER ORDERED that inasmuch as the Commission has taken all action it considers appropriate, all outstanding motions or portions thereof not previously disposed of by orders are hereby denied.

Done at Frankfort, Kentucky, this 31st day of October, 1980.

UTILITY REGULATORY COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Secretary

APPENDIX "A"
 APPENDIX TO AN ORDER OF THE UTILITY REGULATORY
 COMMISSION IN CASE NO. 7568 DATED OCTOBER 31, 1980
 Comparative Rates
 of
 Similar Utilities

	<u>Number of Customers</u>	<u>Approved Rate</u>
Sanitation District No. 1 of Daviess County	213	\$ 15.50
Lake City Water and Sewer District	304	10.00 ¹
Audubon Enterprises	122	8.00 ²

¹Rate based on water consumption \$5.00 for first 2,000 plus \$1.00 per thousand for each additional 1,000 gallons over the minimum.

²Rate based on water consumption \$8.00 for first 3,000 plus \$1.00 per thousand for each additional 1,000 gallons over the minimum.

APPENDIX "B"

APPENDIX TO AN ORDER OF THE UTILITY REGULATORY
COMMISSION IN CASE NO. 7568 DATED OCTOBER 31, 1980

The following rates and charges are prescribed for the customers in the area served by Red Wing Utility Company. 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 date of this Order.

Applicability:

Applicable within the service area served by Red Wing Utility Company namely: Gateway Subdivision, Marshall County; Golden Acres Subdivision, Marshall County; Blandville Estates, McCracken County; Green Acres Subdivision, McCracken County; Fieldmont Estates, McCracken County; Holifield Estates, Graves County.

Availability of Service:

Available to all customers.

<u>Type of Service Provided</u>	<u>Monthly Rate</u>
<u>Single-Family Residential</u>	\$15.00 per Residence
<u>All Other</u>	
First 5,000 gallons	\$15.00 (Minimum Bill)
Over 5,000 gallons	1.00 per 1,000 gallons ¹

¹Per 1,000 gallons of metered water usage. A flat-rate per month can be determined from average usage in lieu of monthly computation of this type bill.