

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF PARK LAKE,)
INC., D/B/A PARK LAKE ESTATES)
SEWAGE SYSTEM TO PETITION FOR) CASE NO. 8534
A RATE ADJUSTMENT)

O R D E R

On June 1, 1982, Park Lake Estates Sewage System ("Park Lake") filed an application with this Commission pursuant to the alternative rate adjustment procedure for small utilities ("ARF") requesting authority to increase its rates by approximately \$17,272 annually, an increase of 296 percent. As a part of its application Park Lake requested interim rate relief of \$11,708 annually, effective June 30, 1982. On June 22, 1982, the Commission suspended the proposed rates 5 months and scheduled a hearing on the interim rate request for August 3, 1982, because of the extremely poor financial condition of Park Lake and the potential for discontinuance of electric service to its sewage treatment system for nonpayment of electric bills. Park Lake also requested to impose a surcharge of \$3.90 to each customer for 3 years to amortize \$10,670 of major repairs which Park Lake considers necessary to continue operating the system. Based on the determination herein the revenues of Park Lake will increase by \$11,380 annually, an increase of 195 percent.

A public meeting was held on July 20, 1982, at the Oldham County Courthouse in LaGrange, Kentucky, for the purpose of receiving public comment and testimony with respect to the proposed rate adjustment.

COMMENTARY

Park Lake is a privately-owned sewage treatment system serving 75 residential customers in Park Lake Estates Subdivision of Oldham County, Kentucky. The owner of Park Lake is Mr. Sam McBroom who presently resides in Seminole, Florida. Mr. Carroll Cogan acts as agent and manager of the system with power to make management and operational decisions.

Park Lake is currently experiencing severe operating problems caused in part by the inattention of the owner to the system. The sewage treatment plant is in a state of disrepair and in violation of environmental pollutant standards of the Kentucky Department for Natural Resources and Environmental Protection, Division of Water. The annual reports on file with the Commission are incomplete and inaccurate even following extensive efforts by the Commission staff to make corrections. Park Lake is currently in arrears on its payments for electric service to the Louisville Gas and Electric Company ("LG&E") and in jeopardy of having its electric service terminated. The processing of this rate application has been delayed because of inadequate and untimely responses to requests for information.

TEST PERIOD

Park Lake proposed and the Commission has accepted the 12-month period ending December 31, 1981, as the test period for determining the reasonableness of the rate approved herein. Appropriate pro forma adjustments have been included for rate-making purposes.

REVENUES AND EXPENSES

Park Lake proposed several adjustments to revenues and expenses as reflected in its proposed operating budget included in the original application. The Commission is of the opinion that the proposed adjustments are generally proper and acceptable for rate-making purposes with the following modifications:

Operating Contract Fee

Park Lake proposed to increase its annual expense for routine maintenance by \$2,820. The routine maintenance is provided under an operating contract with Andriot-Davidson's Service Company, Inc. The proposed increase in expense was based on an increase in the level of maintenance performed under the contract. However, there is no documentation in the record in this case which reflects that the owner of Park Lake has authorized the increased level of routine maintenance and the increased monthly fee. Therefore, the proposed adjustment has not been included herein for rate-making purposes.

Purchased Power Expense

Park Lake proposed to increase the purchased power expense by \$367 based on an estimated increase in the cost of electricity.

The Commission has decreased this adjustment by \$176 to reflect the annual cost of electricity based on the current rates of LG&E.

Chemicals

The proposed operating budget did not include chemicals expense. However, the 1981 annual report contained \$400 in chemicals expense. At the hearing, Mr. Cogan stated that Park Lake should incur an expense of approximately \$2,400 annually for chemicals.⁽¹⁾ The Commission requested that Park Lake provide invoices for the chemicals actually purchased during the test year. Park Lake filed various bills from September 1980 to April 1982 from two different suppliers, totalling \$863. The Commission finds no conclusive evidence in the record in this case to support the proposed annual expense of \$2,400. Therefore, the Commission will include the expense actually incurred during the test period of \$400 for rate-making purposes herein.

Maintenance and Repairs Expense

Park Lake proposed to increase its maintenance and repairs expense by \$2,200. The Commission requested a detailed analysis of the test year maintenance and repairs expense of \$2,000 shown in the 1981 Annual Report. Park Lake provided a list, by date from November 1976 to April 1982, which included various repairs. No dollar amounts were given for many of the repairs listed.

(1) Transcript of Evidence, August 3, 1982, pages 38 and 39.

Only one item included on the list was for the test period, and no dollar amount was given.

The Commission is of the opinion that the \$2,000 of actual maintenance and repairs expense reported in the 1981 annual report has not been supported by the evidence of record in this case, it is not unreasonable for a utility of this size. Moreover, it is obvious to the Commission that the Park Lake sewerage facilities are in a bad state of repair and that some funds must be generated internally to repair and maintain the system. Therefore the \$2,000 of maintenance and repairs expense reported in the 1981 annual report has been included herein for rate-making purposes.

Collection Expense

Park Lake proposed to increase the collection expense by \$270. The Louisville Water Company is responsible for the billing and collecting of revenues from the customers of Park Lake. In projecting this expense Park Lake injected an estimated water charge and the sewer rate proposed in the original application into the formula used by Louisville Water Company to calculate the collection charge. ⁽²⁾ The Commission has modified this calculation to include the rate allowed herein which results in an annual collection expense of \$788.

(2) $1.56 \times \frac{\text{Sewer Charge}}{\text{Water Charge \& Sewer Charge}} \times \text{Number of Customers.}$

Depreciation Expense

Park Lake reported actual depreciation expense for the test year of \$5,385. The Commission finds that depreciation expense should be computed for rate-making purposes on the basis of the original cost of the plant in service less contributions in aid of construction. The record herein reflects that the level of contributions in aid of construction at the end of the test period was \$87,228 which is approximately 54 percent of the total cost of utility plant in service. This results in a reduction to depreciation expense of \$2,933.

The Commission has further adjusted depreciation expense by \$760 to exclude depreciation expense on the excess capacity of the system. ⁽³⁾ The capacity of the Park Lake treatment plant is 80,000 gallons per day ("GPD") and the demand on the system is approximately 30,000 GPD. Since the plant will be able to accommodate new customers in the foreseeable future, the present users of the system should not pay the total cost of this excess capacity. The Commission has decided in fairness to all parties concerned that the costs associated with the excess capacity should be shared equally by the owner and the ratepayers.

Annual depreciation expense after the adjustments for contributions in aid of construction and excess capacity is \$1,692.

(3) $80,000 \text{ GPD} - 30,000 \text{ GPD} = 50,000 \text{ GPD} \div 80,000 \text{ GPD} = .62$.
 $\$5,385 - \$2,933 \text{ (Contributions)} = \$2,452 \times .62 \div 2 = \760 .

Other Tax Expense

Park Lake proposed an adjustment of \$240 to increase the expenses for taxes other than income tax. The Commission requested that Park Lake provide documentation of the proposed increase and no evidence was supplied. Therefore, the Commission has excluded the proposed adjustments.

Income Tax Expense

Park Lake proposed an adjustment to increase its income tax expense by \$700. The Commission has allowed a provision of \$388 for federal and state income taxes based on the level of net income allowed herein and the applicable federal and state income tax rate.

Quarterly Testing Expense

Park Lake proposed an expense of \$440 for quarterly testing required by the Environmental Protection Agency. Testimony by Mr. Larry Smither, Vice President and General Manager of Andriot-Davidson's Service Company, indicated that the correct cost for the test was \$115 per quarter rather than the \$110 used in preparing the proposed operating budget in the original application.⁽⁴⁾ Based on the \$115 per quarter charge, the Commission has included herein an annual expense of \$460.

Insurance Expense

Park Lake proposed an adjustment to increase annual operating expenses by \$300 for liability and property insurance on the

(4) Transcript of Evidence, August 3, 1982, page 8.

system. In response to a request for information by the Commission at the public hearing on August 3, 1982, Park Lake submitted a letter from the Sterling G. Thompson Company stating that the charge for insurance coverage of the Park Lake sewage treatment facility would be \$529 annually. The Commission has, therefore, included \$529 for insurance expense herein.

Office Rent and Management Fee

Park Lake proposed adjustments to include office rent of \$300 and a management fee of \$1,800 in operating expenses. The Commission has reviewed the overall level of operating expenses of Park Lake, the management and supervision of the physical plant and the financial condition of the system. During the test year no costs were incurred by Park Lake for these items, and no evidence was included in this case which reflects that Park Lake has entered into an operating contract which includes these fees. Moreover, the record indicates that although the owner of Park Lake has authorized Mr. Cogan to act as his agent, Mr. Cogan's actual authority is limited in many respects and many of the decisions are made by the owner. Therefore, the Commission has denied this proposed adjustment for rate-making purposes herein.

The effect of the allowed adjustments on the operations of Park Lake is as follows:

	<u>Actual Test Period</u>	<u>Pro forma Adjustments</u>	<u>Adjusted Test Year</u>
Operating Revenues	\$ 5,842	\$ 0	\$ 5,842
Operating Expenses	<u>14,788</u>	<u>367</u>	<u>15,373</u>
Net Income	<u>\$ (8,946)</u>	<u>\$ (367)</u>	<u>\$ (9,531)</u>

REVENUE REQUIREMENTS

The Commission is of the opinion that the operating ratio⁽⁵⁾ of 88 percent proposed by Park Lake is fair, just and reasonable and should be used in this case. It will permit Park Lake to pay its operating expenses, make the major repairs that have been found necessary, and provide a reasonable return to its owner. Therefore, the Commission finds that Park Lake is entitled to increase its rate to produce total revenues of \$17,469 which will require an increase in revenues of \$11,627 annually.

SURCHARGE

Park Lake proposed to include as a part of its monthly rates for service a surcharge of \$3.90 for 3 years to recover the estimated cost of major repairs to the sewage treatment plant. The Commission does not take issue with the necessity of these repairs. It does, however, take issue with the method of funding these repairs. Under normal operating conditions, prudent management would attempt to maintain its plant in order to maximize the useful life of the facilities and to realize the ultimate return on investment. In this case, however, the plant has been inadequately maintained through the negligence of Park Lake's owner and management. The customers of Park Lake have paid the cost of a large portion of the sewage treatment plant and related facilities through the price paid for the lots served by the sewage system.

$$(5) \text{ Operating Ratio} = \frac{\text{Operating Expense} + \text{Depreciation} + \text{Taxes}}{\text{Gross Revenue}}$$

The Commission finds no evidence that could lead it to conclude that the operations of the system will improve. Moreover, if the customers of Park Lake are required to supply additional capital to Park Lake through a surcharge the owner will continue to have little at stake, and we may be assured of continued inadequate operations. Therefore, the Commission is of the opinion that the proposed surcharge should be denied.

OTHER ISSUES

The Commission is very concerned about the amount of increase it must allow in this case and the impact of this increase on the customers of Park Lake. The record in this case shows that the level of expense as allowed herein is required to operate Park Lake on a sound financial basis, even though this level of expense is approximately three times the amount of annual revenue provided by the old rate of \$6.50. The future of Park Lake is dependent upon major improvements in the management of the revenues provided by the customers. The physical plant must also be maintained in good working order and the requirements of governmental environmental protection agencies must be met.

The customers have a vested interest in the reliable, efficient, continued operation of Park Lake. Because of this interest, the Commission is of the opinion that a Customer Council should be formed to work with the management of Park Lake and assist in whatever way practical to see that the additional revenues allowed in this case are utilized in the most efficient

way, that the physical plant is maintained in good working order, and that costs do not increase more than necessary.

Members of the Customer Council should be elected by the customers of Park Lake. Once formed, the council should be the liaison between Park Lake and its customers, keeping both informed of progress toward achieving the ultimate goal of reliable, efficient, cost-effective operations and service at the lowest possible rate. Park Lake should schedule periodic meetings with this council and communicate as often as necessary to keep the customers informed. Initially, Park Lake should inform its customers of its desire to work with the council and assist in its implementation.

SUMMARY

The Commission having considered the evidence of record and being advised, is of the opinion and finds that:

(1) The rate in Appendix A is the fair, just and reasonable rate for Park Lake and will produce annual revenue from customers of approximately \$17,469 and should be approved. This revenue will be sufficient to meet Park Lake's operating expenses found reasonable for rate-making purposes, make the major repairs that have been found to be necessary, and provide a reasonable return to the owner.

(2) The rates proposed by Park Lake would produce revenue in excess of that found reasonable herein and should be denied upon application of KRS 278.030.

(3) The surcharge proposed by Park Lake would produce revenue in excess of that found to be necessary and should be denied.

(4) Park Lake should inform its customers through a direct mailing, of this Commission's wishes that a customer council be formed to work with Park Lake in improving the overall operations, and the financial condition of the utility.

(5) Park Lake should make a diligent effort to see that the Customer Council is formed and to work with that council in the manner prescribed in this Order.

IT IS THEREFORE ORDERED that the rate in Appendix A be and it hereby is approved for service rendered by Park Lake on and after December 1, 1982.

IT IS FURTHER ORDERED that the rate proposed by Park Lake be and it hereby is denied.

IT IS FURTHER ORDERED that the surcharge proposed by Park Lake be and it hereby is denied.

IT IS FURTHER ORDERED that within 30 days from the date of this Order Park Lake shall file with the Commission its revised tariff sheet setting out the rate approved herein.

Done at Frankfort, Kentucky, this 7th day of December, 1982.

PUBLIC SERVICE COMMISSION

Earl Shaw
Chairman

Rosucine Bondall
Vice Chairman

Don Carver
Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION IN CASE NO. 8534 DATED DECEMBER 7, 1982

The following rate is perscribed for all customers in the area served by Park Lake Estates Sewage System in Jefferson County, Kentucky. 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.

RATE: Monthly

Single Family Residential

\$ 19.15 per residence