

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF BROWNSBORO)
UTILITIES, INC. D/B/A OLD)
BROWNSBORO PLACE FOR AN) CASE NO. 8687
ADJUSTMENT OF RATES PURSUANT)
TO THE ALTERNATIVE PROCEDURE)
FOR SMALL UTILITIES)

O R D E R

On October 22, 1982, Brownsboro Utilities, Inc., ("Brownsboro") filed an application with the Commission to increase its rates pursuant to 807 KAR 5:076, Alternative Rate Adjustment Procedure for Small Utilities ("ARF"). As a part of its application, Brownsboro requested that the Commission grant an interim rate increase effective immediately and allow a surcharge to retire outstanding accounts payable for prior years' operating losses. On November 17, 1982, Brownsboro withdrew its request for interim rates and a surcharge. The proposed rates would produce additional revenue of \$27,941, an increase of 83 percent. Based on the determination herein, the revenue of Brownsboro will increase by \$12,740 annually, an increase of 38 percent.

On December 14, 1982, the Consumer Protection Division in the office of the Attorney General moved to intervene in this proceeding pursuant to KRS 367.150(8), which motion was

granted. The residents and officials of the City of Brownsboro requested that a public hearing be held. The Commission scheduled a hearing for March 23, 1983, and directed Brownsboro to give notice to its customers pursuant to KRS 278.185.

COMMENTARY

Brownsboro is a privately-owned sewage treatment system serving 215 residential customers in Old Brownsboro Place and Brownsboro Meadows Subdivisions in Jefferson County.

TEST PERIOD

The Commission has adopted the 12-month period ending December 31, 1981, as the test period for determining the reasonableness of the proposed rates. In utilizing the historical test period, the Commission has given full consideration to known and measurable changes found reasonable.

REVENUES AND EXPENSES

The ARF was established to provide a simplified and less expensive method for small utilities to apply for rate increases with the Commission. Therefore, the financial data from the 1981 annual report is used as the basis for determining the revenue requirements. Brownsboro proposed several adjustments to revenues and expenses as reflected in the application. The Commission is of the opinion that the proposed adjustments are generally proper and acceptable for rate-making purposes with the following modifications:

Purchased Power Cost

Brownsboro proposed to increase purchased power expense by \$3,359 based on a projected increase in the cost of electricity. The Commission has decreased this adjustment by \$1,936 to reflect the annual cost of electricity based on the current rates of Louisville Gas and Electric Company. In determining this adjustment, the Commission used the actual volume of electricity purchased during the test year and applied the rates of Louisville Gas and Electric Company in effect in March 1983.

Water Service Cost

Brownsboro proposed to increase the water service cost by \$98 based on a projected increase in the cost of water from the Louisville Water Company, Inc. ("LWC"). The Commission has increased this adjustment by \$260 to reflect the annual cost of water based on the current rates of LWC. In determining this adjustment, the Commission used the actual quantity of water purchased during the test year and applied the rates of LWC in effect in May 1983.

Maintenance of Treatment Plant

Brownsboro proposed to decrease the expense for maintenance of treatment plant by \$4,697 based on an averaging of 1980 and 1981 costs. The 1981 annual report reflected a test year expense of \$13,881. Of this amount \$8,395 was for the replacement of a pump. Mr. Carroll Cogan,

President of Brownsboro, stated in the hearing that this was an extraordinary expense.¹ In accordance with the Commission's policies such expenditures are not allowed for rate-making purposes; therefore, maintenance of treatment plant expense has been reduced by \$8,395 to exclude this extraordinary expense which results in pro forma maintenance expense of \$5,486.

Collection Expense

Brownsboro proposed to increase collection expense by \$280. LWC is responsible for the billing and collecting of revenues from the customers of Brownsboro. In projecting this expense Brownsboro included an estimated water charge and the sewer rate proposed in the original application in the formula used by LWC to calculate the collection charge.² The Commission has modified this calculation to include the rate allowed herein. The Commission is also using the most recent collection fee effective May 1, 1983, which results in an annual collection expense of \$2,663.

Office Supplies Expense

The 1981 annual report reflected an expense for office supplies of \$198. In response to an information request and through testimony at the hearing it was determined that this amount included not only minimal charges for copy paper and stationery, but an allocated charge for the acquisition of a

¹ Transcript of Evidence, April 23, 1983, page 23.
² $1.72 \times \frac{\text{Sewer Charge}}{\text{Number of Customers}} + \text{Water Charge}$

copy machine to be used by all of the utilities owned or managed by Mr. Cogan. Mr. Cogan testified that the life of the machine should be 4 or 5 years.³ Based on this statement, the Commission has amortized the amount charged to this account over a 4-year period to result in a pro forma office supplies expense of \$50.

Outside Services Employed

The 1981 annual report reflected an expense for outside services employed of \$1,942. In response to an information request and through testimony at the hearing it was determined that this amount included charges from an accountant and an automatic data processing firm for a combined total of \$742. In 1982, Brownsboro acquired the services of Automated Financial Services, Inc., to perform the same accounting functions as the two preceding firms. The annual cost of this service under the new arrangement is \$318. The Commission has, therefore, adjusted the test year expense by \$424 to reflect the reduction in the cost of these services.

Insurance Expenses

Brownsboro proposed to increase the insurance expense by \$433 based on a projected increase in the cost of insurance coverage. The Commission has decreased this adjustment by \$290 to reflect the current rates charged to the utility for property insurance coverage. In determining

³ Transcript of Evidence, March 23, 1983, page 17.

this adjustment, the Commission has used the actual amount billed by the insurance company in 1983 for 12 months of coverage.

Transportation Expense

The 1981 annual report reflected test year transportation expense of \$282. In response to an information request it was stated that the manager's car expense was pro-rated between the various sewer companies owned by Mr. Cogan, including car payments, operating expenses, and travel expenses usually charged on a Visa card. Brownsboro made no car payments in 1981 but did make one Visa payment. The Commission is of the opinion that this is a totally arbitrary method of allocating travel expenses. There was no documentation presented of the amount of travel required of the manager for the purpose of attending to the business of Brownsboro. The Commission has, therefore, disallowed this expense and recommends that if Brownsboro incurs costs in the future for transportation, it should implement an accurate method of determining its appropriate portion of transportation expense.

Miscellaneous General Expenses

During the test period, Brownsboro incurred finance charges of \$1,549 from Andriot-Davidson's Service Company, Inc. ("Andriot-Davidson"). The finance charge is based upon 1 1/2 percent of the outstanding payable to Andriot-Davidson at the end of each month and is reported in Account 930, Miscellaneous General Expenses, by Brownsboro. The proper classification for these expenses would have been to Account

430, Interest on Debt to Associated Companies. These expenses have been disallowed for rate-making purposes for the same reasons as indicated in the following paragraphs relating to other interest expense.

Interest Expense

The 1981 annual report reflected interest expense of \$3,637 for the test period. Included in this amount was interest of \$1,651 on notes payable to associated companies. The purpose of these notes was to obtain funds to pay current operating expenses. The Commission's records reflect that Brownsboro last requested rate relief in 1977. In the years subsequent to the Commission's decision in that case Brownsboro's financial position deteriorated to the point that it could no longer remain current on payments to suppliers. Brownsboro's failure to request rate relief when this situation began to develop is a material reason the notes payable have reached the current level. The burden of obtaining sufficient revenues to pay operating costs rests with the management of Brownsboro. The failure of Brownsboro to seek sufficient revenues to cover its operating costs in prior periods does not justify the recovery of those costs from the present ratepayers. To allow Brownsboro to recover these costs would constitute retroactive rate-making. Therefore, the Commission has excluded the interest on notes payable to associated companies for rate-making purposes.

The allowed interest expense of \$2,165 reflects the annual interest expense on long-term debt outstanding at the end of 1982 at the interest rates applicable at that date.

Depreciation

In response to an information request Brownsboro filed a depreciation schedule based on total utility plant in service of \$32,725. It is the policy of the Commission to compute depreciation expense for rate-making purposes on the basis of the original cost of the plant in service less contributions in aid of construction. The Commission has determined that Brownsboro's contributions in aid of construction represent approximately 31 percent of the total cost of utility plant in service. Utilizing a 15-year life, the depreciation expense has been reduced by \$1,937 for the test period to exclude depreciation on assets purchased with contributions in aid of construction.

Taxes Other Than Income Taxes

The 1981 annual report reflected taxes other than income tax expense of \$656. In response to an information request it was determined that this amount included late payment charges of \$25, which are not allowed for rate-making purposes. The amount charged to this account also included two payments to the City of Brownsboro, one for 1981 taxes and one for 1982 taxes. The Commission has excluded a \$25 payment made in 1981 for the 1982 taxes to limit the expense to those incurred for 1 year. Also included in the \$656 amount was a \$161 amount labeled as property tax.

All known state and local property tax invoices were provided, yet no documentation was provided to substantiate this \$161 amount. The net effect of these adjustments on taxes other than income taxes is a pro forma expense of \$445.

Routine Maintenance Fee

Brownsboro proposed a pro forma adjustment of \$795 to reflect the increase in annual routine maintenance expense. On April 1, 1982, the routine monthly maintenance fee was increased from \$433 to \$550 by Andriot-Davidson. The total annual increase in cost resulting from this increase is \$1,404.

Mr. Cogan owns 100 percent of the stock of Andriot-Davidson and 100 percent of the stock of Brownsboro. Therefore, the contract between these two entities is, by definition, not at arms length. In order to determine the reasonableness of the increased maintenance fee the Commission requested detailed information regarding the services provided, the basis for the determination of the monthly fee, and comparative information for all sewer plants serviced by Andriot-Davidson. Although objecting to the requested information, Brownsboro filed a partial response to the request.

After a review of the information provided, the Commission is of the opinion that due to the failure to provide certain items of information requested, a determination can not be made that the increase in cost to

Brownsboro is reasonable. The information supplied by Brownsboro in response to the Commission's Order of January 26, 1983, reflects that Andriot-Davidson provides routine maintenance services to 71 sewer treatment facilities at various monthly or annual fees. The Commission requested in item 2a the effective date of the routine maintenance fee and in item 2b the previous monthly routine maintenance fee. Brownsboro failed to supply this information which would reflect whether similar price increases were implemented for other facilities serviced by Andriot-Davidson. The Commission was also unable to make any comparison of the services being provided to the various facilities serviced by Andriot-Davidson due to the failure of Brownsboro to file copies of contracts and annual data relating to actual services provided to each facility. In response to the Commission's request for documentation of negotiations with entities other than Andriot-Davidson for routine maintenance services, Brownsboro filed only one estimate. Although this estimate was higher than the proposed fee to be charged by Andriot-Davidson no information was supplied with regard to the services to be provided by the other entity for the price quoted. In response to the Commission's inquiry as to whether Brownsboro had considered alternatives to contracting for the routine monthly maintenance, Brownsboro responded in general terms that the costs of hiring someone and handling the paperwork for employment taxes would preclude that possibility.

The Commission is becoming increasingly concerned about the rising costs of sewer utilities and, with regard to sewer utilities owned by Mr. Cogan, the increasing complexity of intercompany transactions. The Commission is of the opinion and finds that Brownsboro has not met its burden of proof that the increase in the routine monthly maintenance fee is reasonable and therefore has denied the additional cost for rate-making purposes herein. Therefore, an adjustment has been made to reduce the annual cost incurred during the test year by \$609, to reflect the annual cost of routine plant maintenance at \$433 per month which was the rate in effect prior to April 1, 1982.

Income Taxes

Brownsboro, a Subchapter S Corporation, proposed an adjustment to increase income tax expense by \$1,864. The Commission is of the opinion that the stockholders, who determined to organize Brownsboro as a Subchapter S Corporation under Internal Revenue Code Section 1371, must bear any liability resulting from this decision. Therefore, in accordance with past policy, the Commission has not included a provision for state or federal income taxes herein.

After consideration of the aforementioned adjustments the Commission finds that Brownsboro's test period operations are as follows:

	<u>Actual Test Year</u>	<u>Pro Forma Adjustments</u>	<u>Adjusted Test Year</u>
Operating Revenues	\$ 33,513	\$ 0	\$33,513
Operating Expenses	<u>48,169</u>	<u><9,372></u>	<u>38,797</u>
Operating Income	\$<14,656>	\$ 9,372	\$<5,284>
Interest Expense	<u>3,637</u>	<u><1,472></u>	<u>2,165</u>
Net Income	<u>\$<18,293></u>	<u>\$10,844</u>	<u>\$<7,449></u>

REVENUE REQUIREMENTS

The Commission is of the opinion that an operating ratio of 88 percent is fair, just and reasonable and should be used to determine the revenue requirements of Brownsboro. This methodology will provide sufficient revenue to permit Brownsboro to pay its operating expenses and provide a reasonable surplus. Therefore, the Commission finds that Brownsboro is entitled to increase its rates to produce total revenues of \$46,253 which will require an increase in revenues of \$12,740 annually.

SUMMARY

The Commission, after consideration of 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 Brownsboro in that it will produce annual operating revenues of approximately \$46,253 for Brownsboro and should be approved. These revenues will be sufficient to meet Brownsboro's operating expenses found reasonable for rate-making purposes, service its debt, and provide a reasonable surplus.

2. The rate proposed by Brownsboro would produce revenue in excess of that found reasonable herein and should be denied.

IT IS THEREFORE ORDERED that the rate in Appendix A be and it hereby is approved for service rendered by Brownsboro on and after the date of this Order.

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

IT IS FURTHER ORDERED that within 30 days from the date of this Order Brownsboro shall file with this Commission its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 8th day of July, 1983.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 8687 DATED July 8, 1983.

The following rates and charges are prescribed for the customers in the area served by Brownsboro Utilities, 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.

CLASSIFICATION OF SERVICE

RATE

Single Family Residential

\$17.93 per month