

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF ENVIRO)
UTILITIES, INC., FOR AN) CASE NO. 8688
ADJUSTMENT OF RATES)

O R D E R

On October 22, 1982, Enviro Utilities, Inc., ("Enviro") filed its application with this Commission to increase its rates pursuant to 807 KAR 5:076, Alternative Rate Adjustment Procedure for Small Utilities ("ARF"). The proposed rates would produce additional revenue of \$40,300 annually, an increase of 83 percent. However, based on normalized test year revenue the actual increase requested would be \$36,082, an increase of 68 percent. Based on the determination herein the revenues of Enviro will increase by \$5,559 annually, an increase of 10 percent.

No hearing was held in this matter, and accordingly, the decision of the Commission is based on information contained in the application, written submissions, annual reports and other documents on file in the Commission's offices.

COMMENTARY

Enviro is a privately owned sewage treatment system organized and existing under the laws of the Commonwealth of

Kentucky, and serving approximately 546 customers 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 use in applying 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. Enviro proposed several adjustments to its test period revenues and expenses. The Commission is of the opinion that the proposed adjustments are generally proper and acceptable for rate-making purposes with certain modifications. In addition, the Commission has made several adjustments to Enviro's test period operating statement to reflect actual and anticipated operating conditions.

Operating Revenue

The actual operating statement of Enviro for the test period reflected operating revenue of \$48,634. The

Commission has increased operating revenue by \$4,218 to reflect the normalized annual revenue based on the number of customers at test year end.

Maintenance Expense

Enviro proposed an adjustment to increase its maintenance expense by \$3,001. The proposed adjustment was based upon the average of the 1980 and 1981 levels of maintenance expense. Enviro's position is that due to its tenuous financial condition repairs during the test period were done on an emergency basis only and therefore are not representative of a normal level of maintenance expenses.

The Commission has reviewed the information filed by Enviro as well as its annual reports for previous years and does not concur with the adjustment as proposed by Enviro. The method of computing the maintenance adjustment results in a projection of future costs which is speculative. The average of 2 years' maintenance expenses can produce widely varying results in some instances and can not be relied upon to produce a normal level of expense. Moreover, the 2 years used in arriving at the average maintenance cost contain items which should have been capitalized in accordance with the Uniform System of Accounts prescribed by this Commission. Therefore, the Commission has allowed Enviro's test period level of expense exclusive of extraordinary and capital expenditures. The Commission has capitalized \$389 representing the installation of an alarm system at the

treatment plant and \$1,157 representing the installation costs of an aerator installed at the treatment plant. After taking into consideration the adjustments made by the Commission the maintenance expense allowed herein is \$3,365.

Electric Expense

Enviro proposed an adjustment to increase electric expense by \$921. In order to assess the accuracy of the reported level of expense, as well as to determine the adjusted electric expense, the Commission requested and Enviro has supplied copies of its test period electric bills from Louisville Gas and Electric Company. In calculating the adjusted electric expense the Commission has applied the current rates in effect to the actual KWH used by Enviro during the test year. This results in adjusted electric expense of \$10,013.

Miscellaneous General Expenses

During the test period, Enviro incurred finance charges of \$1,794 from Andriot-Davidson's Service Company ("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 Expense.

The Commission has reviewed the request to recover these finance charges in this case. Commission records indicate that Enviro last requested rate relief in 1977. In the years subsequent to the Commission's decision in that

case Enviro's financial condition has deteriorated to the point that it could no longer remain current on its payments to vendors. Obviously, Enviro's failure to request rate relief while this situation developed is a material reason the finance charges have reached their current level. The burden of obtaining sufficient revenues to pay operating costs clearly rests with the management of Enviro. The failure of Enviro to seek sufficient revenues to cover its operating costs in prior periods does not justify the request in this case to recover these costs from the present ratepayers. To allow Enviro to recover the cost of financing operations of prior years would constitute retroactive rate-making. Therefore, the Commission has excluded the finance charges for rate-making purposes herein.

Interest Expense

Enviro proposed a pro forma adjustment to increase its interest expense by \$7,851, which represents interest expense on a \$100,000 note payable, incurred to finance the purchase of the sewer system in 1976. In Case No. 6554 Enviro was granted permission to purchase the system. However, Enviro did not request and was not granted approval of the financing associated with the purchase of the system. The annual reports filed by Enviro do not provide sufficient information for the Commission to determine if the purchase was within the terms and conditions of the lease purchase agreement and to determine the appropriate accounting entries

to record the purchase. The Commission can not allow interest costs on debt which it has not approved to be borne by the customers of Enviro. Therefore, the Commission has excluded this interest for rate-making purposes herein.

Of the remaining interest expense \$555 is accrued interest on notes payable to associated companies and \$5,550 is interest accrued on a demand note payable to the Carroll Cogan Companies Special Loan Account, an account established by Mr. Carroll Cogan, owner of Enviro, for the purpose of lending money to those utilities which can not obtain financing elsewhere. When questioned concerning the use of the proceeds of these obligations Enviro stated in item 11 of its response to the Commission's Order of April 22, 1983, and item 5 of its response to the Attorney General's request of December 13, 1982, that these funds were used to cover current operating expenses.

As noted in the preceding adjustment it is clearly the function of Enviro's management to obtain sufficient revenues to pay current operating expenses. If Enviro had sought timely rate relief the necessity of obtaining debt funds to pay operating expenses would have been avoided. To allow Enviro to recover the interest expense associated with this debt would constitute retroactive rate-making. Therefore, the Commission has disallowed the interest accrued on debt used to pay operating expenses for rate-making

purposes herein. In addition, the Commission has excluded interest expense of \$949 on a note which was paid off during the test year.

Routine Maintenance Expense

Enviro proposed a pro forma adjustment of \$1,575 to reflect the increase in annual routine maintenance expense. On April 1, 1982, the routine monthly maintenance fee was increased from \$590 to \$775 by Andriot-Davidson. The total annual increase in cost resulting from this increase is \$2,220

Mr. Cogan owns 100 percent of the stock of Andriot-Davidson and 100 percent of the stock of Enviro. 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, Enviro filed a partial response to the request.

After a review of the information provided, the Commission is of the opinion that due to Enviro's failure to provide certain items of information requested, a determination can not be made that the increase in cost to Enviro is reasonable. The information supplied by Enviro 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. Enviro failed to supply this information which would have reflected whether similar price increases were implemented for other facilities serviced by Andriot-Davidson. The Commission was also unable to compare the services being provided to the various facilities serviced by Andriot-Davidson due to the failure of Enviro 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, Enviro 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 Enviro had considered alternatives to contracting for the routine monthly maintenance, Enviro 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 Enviro 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 \$645 to reflect the annual cost of routine plant maintenance at \$590 per month which was the rate in effect prior to April 1, 1982.

Depreciation Expense

The actual operating statement of Enviro for the test period reflected depreciation expense of \$14,909. 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 at the end of the test period less contributions in aid of construction. Enviro's balance sheet reflects that the level of contributions in aid of construction at the end of the test year was \$34,980 which is approximately 17 percent of the total cost of utility plant in service. In determining the pro forma depreciation expense the Commission has utilized the level of plant in service at the end of the test year, exclusive of contributions in aid of construction, and the applicable depreciation rates used by Enviro. In addition, the Commission has included depreciation expense of \$78 on the

installation cost of an alarm system, and \$386 for an aerator which should have been capitalized as stated in a preceding adjustment. The depreciation expense was based on an estimated useful life of 5 years on the installation of the alarm system and 3 years on the aerator installation. After excluding depreciation associated with contributed property and including depreciation on the items capitalized by the Commission the resulting depreciation expense allowed herein is \$13,944.

Transportation Expense

Enviro incurred \$400 of transportation expense during the test period. In response to item 7 of the Commission's Order dated December 13, 1982, Enviro indicated that the \$400 represented two credit card payments of \$200 each. The Commission has excluded this expense for rate-making purposes because of Enviro's failure to establish that it and its customers derived any benefit from these expenditures. When questioned, Enviro stated that the manager's car expense is pro-rated between the various sewer companies owned by Mr. Cogan and the credit card payments represent miscellaneous supplies, vehicle operating expense and travel of the manager. No evidence has been entered by Enviro that these payments are in any way related to the manager's travel associated with Enviro. Therefore, the Commission has reduced operating expenses by \$400 to exclude this expense.

Insurance Expenses

Enviro proposed to increase the insurance expense by \$475 based on a projected increase in the cost of insurance coverage. The Commission has decreased this adjustment by \$400 to reflect the current rates charged to the utility for property insurance coverage. In determining this adjustment, the Commission has used the actual amount billed by the insurance company in 1983 for 12 months of coverage.

Agency Collection Fee

Enviro projected expenses of \$2,100 related to the collection of its bi-monthly sewer bill by the Louisville Water Company. The adjustment is based on the proposed rate as a percentage of the total sewer and water bill multiplied by the collection charge per bill. The Commission has computed Enviro's pro forma collection expense based upon the rates allowed herein. This results in collection expense of \$2,055.

Income Taxes

Enviro projected income tax expense of \$2,668 based upon the level of net income requested and a 20 percent tax rate. The 1981 federal income tax return filed by Enviro reflects that it is operating as a Subchapter S Corporation. The Commission is of the opinion that the stockholders, who determined to organize Enviro 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.

The Commission finds that Enviro's adjusted test period operations are as follows:

	<u>Actual Test Period</u>	<u>Pro forma Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenue	\$ 48,634	\$ 4,218	\$52,852
Operating Expense	55,592	<4,190>	51,402
Operating Income	\$ (6,958)	\$ 8,408	\$ 1,450
Other Deductions	7,054	<7,054>	-0-
Net Income	<u>\$ (14,012)</u>	<u>\$15,462</u>	<u>\$ 1,450</u>

REVENUE REQUIREMENTS

The Commission is of the opinion that the operating ratio¹ is a fair, just and reasonable method for determining revenue requirements in this case. The Commission finds that an operating ratio of 88 percent will allow Enviro to pay its operating expenses and provide a reasonable return to its owners. Therefore, the Commission finds that Enviro is entitled to increase its rates to produce total annual revenue of \$58,411 which will require an increase of \$5,559 annually.

OTHER ISSUES

Enviro's 1981 tax return lists other income from "tap fees" of \$23,780² and the 1981 balance sheet³ lists an increase of the same amount in Contributions in Aid

¹ Operating Ratio = $\frac{\text{Operating Expense} + \text{Depreciation} + \text{Taxes}}{\text{Gross Revenue}}$

² 1981 Federal Income Tax Return, Line 10.

³ 1981 Annual Report, Page 3, Line 42.

of Construction. No service connection charges are listed in Enviro's tariff, and no deviation from the policy disallowing service connection charges for privately owned sewer utilities has been noted. This discrepancy should be addressed by Enviro before any additional customers are connected to the system.

SUMMARY

The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that:

(1) The rates in Appendix A will produce gross annual operating revenue of \$58,411 and are the fair, just and reasonable rates to be charged in that they will allow Enviro to pay its operating expenses and provide a reasonable surplus for equity growth.

(2) The rates proposed by Enviro should be denied.

IT IS THEREFORE ORDERED that the rates proposed by Enviro be and they hereby are denied.

IT IS FURTHER ORDERED that the rates in Appendix A be and they hereby are approved for service rendered by Enviro on and after the date of this Order.

IT IS FURTHER ORDERED that within 30 days of the date of this Order Enviro shall file the revised tariff sheets setting forth the rates approved herein.

IT IS FURTHER ORDERED that Enviro shall file with the Commission, within 30 days of the date of this Order, its service connection charge policy and a comprehensive listing of customers assessed a service connection charge including the amount of any service connection charge, the service address and the date the charge was assessed, and if no service connection charges were assessed, an explanation of the other income entry of \$23,780 in the 1981 Federal Income Tax Return and the \$23,780 increase in Contributions in Aid of Construction in the 1981 annual report.


IT IS FURTHER ORDERED that Enviro shall refrain from charging any unauthorized service connection charges.

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

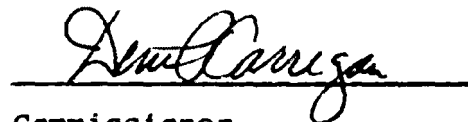
PUBLIC SERVICE COMMISSION



Chairman



Vice Chairman



Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 8688 DATED July 8, 1983.

The following rates are prescribed for all customers served by Enviro Utilities, Inc. All other rates and charges not specifically mentioned herein shall remain the same as those in effect prior to the date of this Order.

<u>CLASSIFICATION</u>	<u>MONTHLY RATE</u>
Residential	\$ 9.20
Educational	9.20
Commercial	9.20*
Apartments	7.70

*Per Residential Equivalent