COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

APPLICATION OF WAVERLY SANITATION FACILITIES, INC. FOR RATE INCREASE PURSUANT TO ALTERNATE RATE ADJUSTMENT PROCEDURES FOR SMALL UTILITIES	)	CASE NO. 8763

O R D E R

On January 31, 1983, Waverly Sanitation Facilities, Inc., ("Waverly") filed an application with the 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 $5,814 annually, an increase of 100 percent. The Commission has granted the entire request.

On February 17, 1983, Mr. Norman Terry, a customer of Waverly and on February 28, 1983, Mr. Edward W. Humphries, an owner of one of the apartment buildings served by Waverly, moved to intervene in this proceeding pursuant to KRS 367.150 (8), which motions were granted. The Commission scheduled a hearing on the matter for April 7, 1983, and directed Waverly to give notice to its customers pursuant to KRS 278.185.

COMMENTARY

Waverly is a privately-owned sewage treatment system serving 17 four-plex apartments in Standing Oaks Subdivision in Jefferson County, Kentucky.

TEST PERIOD

The Commission has adopted the 12-month period ending December 31, 1982, 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. The financial data from the 1982 annual report is used as the basis for determining the revenue requirements. Waverly proposed several adjustments to projected 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:

Operating Revenue

The Commission has increased revenue by $1,084 to reflect the amount of revenue that should be produced by the current rate based on the number of customers at the end of the test year.

Routine Maintenance Service Fee

Waverly's 1982 annual report reflected $3,160 in Account 710-A, Routine Maintenance Service Fee. Due to Waverly's failure to provide a breakdown of this account as requested at the hearing, the Commission can not determine the validity of the costs that comprise this amount. Therefore, the Commission has reduced this amount by $1,960 resulting in pro forma routine maintenance service fee of $1,200. The allowed expense is based on a copy of the service contract with Jack Wolford Enterprises, Inc., which provides for a fee of $100 per month, effective May 1, 1983.

Maintenance of Structures

The 1982 annual report reflected $5,188 in Account 711, Maintenance of Structures and Improvements. In response to an information request Waverly filed a breakdown of this account which listed an expense of $3,480 paid to the Louisville Gas and Electric Company for electric power. Although this is a proper operating expense it has been improperly assigned and should have been included in Account 703, Fuel and Power Purchased for Pumping and Treatment.

Various expense vouchers submitted by Waverly disclose that it is partially utilizing the cash basis of accounting. The Uniform System of Accounts for Class C and D Sewer Utilities requires the accrual method of accounting. In order to convert the Maintenance of Structures and Improvements account to the accrual method, the Commission has increased the amount of expense by $520 to reflect purchases made during 1982, which were not paid for and included in accounts payable at December 31, 1982.

The cumulative effect of these two adjustments is to decrease the test period maintenance of structures expense by $2,960.

Administrative and General Salaries

Waverly proposed to increase the administrative and general salaries by $600. The increase would provide an annual fee of $2,400 for Mr. Jack Farley, owner of Waverly. The Commission has reviewed the operations of Waverly and the duties and responsibilities of Mr. Farley. Based on the routine services provided to Waverly by Mr. Farley, and in comparison with similar sewer utilities with owner/operator arrangements under the jurisdiction of this Commission, the Commission finds that the $2,400 annual fee is excessive. Therefore the Commission has found the test year amount of $1,800 of administrative and general salaries to be reasonable.

Office Supplies and Other Expenses

The 1982 annual report reflected $1,124 in Account 921, Office Supplies and Other Expenses. In response to an information request and through testimony at the hearing[1] it was determined that this account included fuses, crushed stone and other items purchased for plant maintenance purposes. Although these are proper operating expenses they have been improperly assigned and should have been included in Account 711, Maintenance of Structures and Improvements.

Outside Services Employed

Waverly proposed to increase the outside services employed expense by $540 to reflect the current charges for accounting

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1 Transcript of Evidence, April 7, 1983, page 49.

services. Due to Waverly's failure to provide an accurate breakdown of the charges for services provided, the Commission was unable to ascertain the actual expense incurred during the test period for accounting services and has therefore allowed for rate-making purposes only the $330 expense reflected in the 1982 annual report.

Depreciation Expense

Waverly reported depreciation expense of $3,940 during the test year based on the total utility plant in service of $89,376 and an accelerated depreciation rate. The Uniform System of Accounts for Class C and D Sewer Utilities requires the use of the straight-line depreciation method. Insufficient information was supplied to determine the actual depreciation based on the various components of plant in service. Therefore, the Commission finds that a 20-year life is reasonable and has included depreciation expense on that basis for rate-making purposes. However, the utility should break down its plant account into categories and begin accruing depreciation for accounting purposes based on straight-line depreciation over the estimated useful lives of the various items of plant-in-service.

The Commission further adjusted depreciation expense downward by $1,475 to exclude depreciation expense on the excess capacity of the system.[2] The capacity of the Waverly treatment

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2 60,000 GPD - 20,400 GPD = 39,600 GPD ÷ 60,000 GPD = .66
$4,469 X .66 ÷ 2 = $1,475.

plant is 60,000 gallons per day ("GPD") and the demand on the system is approximately 20,400 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.

These adjustments result in pro forma depreciation expense of $2,950.

Taxes Other Than Income Taxes

The 1982 annual report reflected taxes other than income taxes of $285. This amount included late payment charges of $10 which are considered unacceptable for rate-making purposes. The amount charged to this account did not include the $50 Public Service Commission Assessment which has been included. The net effect of these adjustments on taxes other than income taxes results in a pro forma expense of $325.

Sludge Hauling Expense

The 1982 annual report reflected $190 in Account 930, Miscellaneous General Expense. In response to an information request and through testimony at the hearing it was determined that this expense was for the hauling of two loads of sludge at $95 per load. The Commission has recognized this as a proper operating expense for rate-making purposes herein. However, sludge hauling costs should be charged to Account 701, Labor and Expenses.

Fuel and Power Purchased

Waverly's reported costs of electricity for the test year were $3,480. This amount was erroneously charged to Account 711, Maintenance of Structures and Improvements. The Commission has decreased this amount by $980 to reflect the annual cost of electricity based on the current rates of Louisville Gas and Electric Company. To determine this adjustment the Commission requested copies of the electric bills, but Waverly failed to provide them. However, a statement of KWH billed by Louisville Gas and Electric Company was provided in response to requests at the hearing. Using the volume of electricity purchased during the test year and applying the rates in effect in June 1983 the Commission has calculated the pro forma expense of $2,500.

Water Service Cost

Waverly included $1,329 in test year expenses for water service. This was the amount actually paid in 1982, rather than the amount billed. The Commission has decreased this amount by $51 to reflect the annual cost of water based on the current rates of Louisville Water Company, Inc. ("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 June, 1983.

Agency Collection Fee

Waverly proposed to increase its expense for LWC collection fees by $41. LWC is responsible for the billing and collecting of revenues from the customers of Waverly. In projecting this expense Waverly estimated a charge of $1.56 per bill. The

Commission has recalculated the LWC collection fee based on the formula used by LWC including the average monthly water bill for the customers of Waverly and the sewer rate allowed herein.[3] Effective May 1, 1983, the LWC joint use fee has increased to $1.72 per bill. Using this cost per bill to determine Waverly's charges results in an annual agency collection fee of $276.

Chemicals

Waverly proposed in its application to increase chemical expense by 6.8 percent; however, the 1982 annual report showed no expense in Account 704, Chemicals. No invoices were submitted by Waverly to support the reported chemical expense for 1982 despite repeated requests. The Commission is of the opinion that Waverly has not provided sufficient information to determine a reasonable level of chemical expense to be included for rate-making purposes. Therefore, no allowance has been made herein for chemical expense.

Rate Case Expenses

Waverly submitted invoices totaling $2,830 for rate case expenses. Included in this amount was $1,950 for legal fees. The participation of attorneys in this rate case was not evidenced by the filings of information or legal documents or by legal representation at the public hearing in this matter. Documents submitted in response to information requests did not reflect the use of professional assistance. Therefore, the Commission can not

3 $1.72 \times \frac{\text{Sewer Charge}}{\text{Water Charge + Sewer Charge}} \times \text{Number of Customers}$

find that an allowance for legal fees is justified for rate-making purposes.

Also included in this category was $140 to LWC for a customer printout. After examination of the invoice submitted in support of this cost it was determined that this fee was charged to Third Street Sanitation, rather than Waverly. Therefore, the Commission has not included this item as a rate case expense herein.

Mr. Jack Farley included a charge of $250 in the rate case expenses for his time spent in preparing this case. Mr. Farley is the owner of Waverly and receives an annual management fee of $1,800. The Commission is of the opinion that under these circumstances the $250 charge is unjustified and should not be allowed as a rate case expense.

The net effect of these adjustments results in total rate case expenses of $490. In accordance with past policy, the Commission has amortized this expense over a 3-year period, resulting in an adjusted amount of $163.

<u>Laboratory Fees</u>

Due to Waverly's utilization of the cash method of accounting, no laboratory fees were listed in the 1982 annual report. In response to an information request Waverly submitted invoices for laboratory services received in 1982 totaling $600 that were not paid during the test year. This is a proper operating expense, allowable for rate-making purposes, and should be included in Account 701, Labor and Expenses.

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

	Actual Test Year	Pro forma Adjustments	Adjusted Test Year
Operating Revenues	$ 4,730	$ 1,084	$ 5,814
Operating Expenses	16,019	(643)	15,376
Operating Income	$(11,289)	$ 1,727	$ (9,562)
Other Deductions	200	(190)	10
Net Income	$(11,489)	$ 1,917	$ (9,572)

REVENUE REQUIREMENTS

The Commission is of the opinion that the adjusted operating loss is clearly unjust and unreasonable. Further, the Commission is of the opinion that the proposed apartment rate of $57 per month should be approved as the revenues of $11,628 generated by that proposed rate will improve Waverly's financial position. However, the Commission is concerned that while the apartment rate requested by Waverly and approved herein will improve Waverly's financial position, it is inadequate to produce net income from operations. While Waverly's financial condition may be further improved by future growth, the Commission is of the opinion that it will be unable to continue operating for an extended period of time at this rate under current operating conditions.

The Commission has made adjustments to reflect a normal level of revenue and expenses for rate-making purposes. Some of the adjustments were necessary because Waverly failed to follow accounting practices as prescribed by the Uniform System of

Accounts for Class C and D Sewer Utilities. Rate proceedings filed under the ARF require that the utility maintain adequate financial records and that the annual reports be reasonably accurate. Therefore, in the future Waverly should be aware of this requirement and maintain accurate and complete records in order to comply with the regulations established by this Commission.

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 are the fair, just and reasonable rates for Waverly in that they will produce annual operating revenues of approximately $11,628 and should be approved.

2. The rates proposed by Waverly are unfair, unjust and unreasonable and should be denied.

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

IT IS FURTHER ORDERED that the rates proposed by Waverly be and they hereby are denied.

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

Done at Frankfort, Kentucky, this 1st day of July, 1983.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE COMMISSION IN CASE NO. 8763, DATED July 1, 1983.

The following rates are prescribed for the customers in the area served by Waverly Sanitation Facilities, Inc., located 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.

Rates: Monthly

Residential	$14.00 per residence
Commercial, Churches and Schools	$ 3.00 per 1,000 gals.*
Apartments	$14.25 per apartment or 57.00 per four-plex building

*Based on metered water usage.