

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF THIRD STREET)
SANITATION, INC. FOR AN ADJUST-)
MENT OF RATES PURSUANT TO THE) CASE NO. 8783
ALTERNATIVE PROCEDURE FOR SMALL)
UTILITIES)

O R D E R

On March 10, 1983, Third Street Sanitation, Inc., ("Third Street") filed an application with the Commission to increase its sewer rates pursuant to 807 KAR 5:076. This regulation allows utilities with 400 or fewer customers or \$200,000 or less gross annual revenues to use the alternative rate filing method ("ARF") in order to minimize the necessity for formal hearings, to reduce filing requirements and to shorten the time between the application and the Commission's final Order. This procedure minimizes rate case expenses to the utility and, therefore, results in lower rates to the ratepayers. Third Street requested rates which would produce annual revenues of approximately \$74,423. In this Order, the Commission has allowed rates to produce an increase of \$1,300.

Public hearings were held in this matter on May 9, 1983, and July 5, 1983, in the Commission's offices in Frankfort, Kentucky. The Consumer Protection Division of the Attorney General's Office ("AG") was permitted to intervene. Further, the

Commission allowed Mr. Dan Seum, a member of the Kentucky Legislature from Jefferson County, and Mr. Gary Berger, President of the Windsor Place Homeowners Association, to make statements in the record of evidence. Mr. Berger filed a petition on behalf of the customers of Windsor Place Subdivision. The AG filed its brief on August 19, 1983; and Third Street filed its brief on August 11, 1983, and a reply brief on August 26, 1983. All information requested has been submitted.

TEST PERIOD

For the purpose of determining the reasonableness of the proposed rates, the 12-month period ending December 31, 1982, has been accepted as the test period.

REVENUES AND EXPENSES

Third Street proposed no specific adjustments to test period operations with the exception of pro forma information furnished in its responses to the Commission's requests for additional information. The Commission advises Third Street that prior to filing future rate cases, it should familiarize itself with the Commission's policy concerning pro forma adjustments, and its filings and records should adhere to the Uniform System of Accounts for Sewer Utilities as prescribed by this Commission.

Operating Revenues and Uncollectible Accounts

Third Street reported gross sewer revenues of \$45,858 for the test period. However, this figure represents the net amount after deductions by the Louisville Water Company ("LWC") for such items as the LWC collection charges, the National Association Credit Management charges, two payments on Third Street's water

bill for the test period and net uncollectibles on customer billing. The Commission examined the LWC print-out sheets of Third Street and determined that there were net uncollectibles of \$911 which were deducted by the LWC before the sewer revenue was reported on the LWC remittance advices during the test period. Moreover, the Commission also made an analysis of the monthly LWC remittance advices for the test period and finds that an adjustment of \$1,703 in addition to the \$911 is required to arrive at adjusted gross sewer revenues of \$48,472. The Commission has allowed the net uncollectibles of \$911 as an operating expense for rate-making purposes.

Management Fee

Third Street's test period expenses included \$5,400 compensation paid to Mr. Jack Farley for management services. At the July 5, 1983, hearing, Mr. Farley stated that he provides office space, a secretary, desk, files and a truck in addition to his management services.^{1/} All routine service operations are performed by Jack Wolford Enterprises and the billing and collections are performed by the LWC. Thus, the functions performed by Mr. Farley are limited to part-time administrative duties. Based on its experience with other similarly operated sewer utilities, the Commission is of the opinion that \$5,400 for management services is excessive and should be reduced to the following allowances:

Management Fee	\$1,800
Office Expense	<u>1,200</u>
Total	<u>\$3,000</u>

Sludge Hauling

Third Street recorded sludge hauling expense for the test period of \$1,993. The Commission has made an additional allowance to recorded expense of \$508, which represents a December 1983, accounts payable of Third Street for four loads of sludge hauled by F and W Tank Service.

Water Expense

Third Street's test period history of untimely payments to LWC and the fact that the only record of water "expense" was the 2 months' deductions to revenues of \$1,197 described above, made it impossible to determine the appropriate test period level of water expense. Therefore, the Commission obtained this information directly from the LWC and has accepted water expense for the test period of \$2,530.^{2/}

Purchased Power Expense

The Commission has reduced Third Street's purchased power expense for the test period of \$16,978 by \$1,214. Third Street erroneously included purchased power expense of \$1,214 for the month of January, 1983, in its test period expense. Moreover, the Commission also finds it appropriate to increase this operating expense by \$1,182, which represents the 7.5 percent increase granted the Louisville Gas and Electric Company in its last rate case before the Commission (Case No. 8616), granted subsequent to the test period in this case. Therefore, the Commission has included adjusted purchased power expense of \$16,946.

Chemical Expense

Third Street erroneously charged purchases of chlorine from Ulrich Chemical, Inc., of \$416 to the operating expense account, Labor, Materials and Expenses. To this identified chemical expense, the Commission has made an additional allowance of \$274 based on accounts payable to Ulrich Chemical, Inc., and reflects amounts used during the month of December, 1982.^{3/}

Routine Maintenance Service Fee

Third Street's recorded expense for routine maintenance service fees during the test year was \$7,887. An analysis by the Commission of the invoices of Jack Wolford Enterprises, Inc., and the Andriot Davidson's Service Company disclosed that only \$6,030 was paid during the year 1982 for routine maintenance services and the balance of \$1,857, represented various repairs made by Jack Wolford Enterprises, Inc., to the sewer system which is recorded as other repairs and maintenance. Third Street furnished the Commission a copy of an agreement between Jack Wolford Enterprises, Inc., and Third Street dated March 31, 1983, stipulating that the monthly routine maintenance service fee would be increased to \$590 per month beginning May 1, 1983. The Commission is therefore of the opinion that the annualized routine maintenance service fee of \$7,080 should be allowed as an operating expense for rate-making purposes.

Agency Collection Fee

Third Street had recorded expenses for the collection of its bi-monthly sewer bill by the LWC of \$1,738. The Commission has made an adjustment of \$295^{4/} to increase this expense to

\$2,033 to reflect the apportionment of the joint service cost of the collection agency for each bi-monthly bill which reflects the charge for water and the increase in the sewer service bill allowed herein.

Outside Services Employed

From the record, the Commission determined that Third Street incurred legal and accounting fees during 1981 which were paid during the test period. The Commission requested and received from the attorney and accountant itemized bills for their services rendered to Third Street during the test period. The Commission, after examining the filed statements, is of the opinion that \$955 for the accountant and \$95 for legal expenses should be considered allowable recurring operating expenses, and the balance of \$1,145 of legal fees should be transferred to rate case expense to be considered further herein.

Insurance Expense

Third Street's recorded insurance expense for the test period was \$397. In the hearing of July 5, 1983, Third Street provided evidence showing that Third Street paid to the Lewis Davis Insurance Service, Inc., premiums totalling \$551 during the test period for the purpose of vandalism, liability, fire and extended coverage. The Commission is therefore of the opinion that an adjustment of \$154 should be allowed for the total premium paid by Third Street.

Rate Case Expense

During the test period, Mr. Farley was paid \$2,000 for his services in the preparation of the rate case. Moreover, as

previously discussed, the itemized invoice for legal fees as submitted by Mr. Harley N. Blankenship, attorney for Third Street, indicated that \$1,145 of the total amount was attributable to his participation in the rate case. Due to the complexity of the issues in the rate case which required two hearings, the case was changed from the ARF method to a formal rate application requiring public hearings.

After reviewing all of the testimony filed in the record concerning the services of Mr. Farley and Mr. Blankenship, the Commission has determined that Mr. Farley's fee of \$2,000 should be reduced to \$1,000 because of the poor preparation and condition in which the case was filed. The Commission's staff was, as a result of the inadequate filing, required to spend far more than a usual amount of time to sort through the invoices in this case simply to verify and classify operating expenses. Furthermore, the Commission's allowance of a management fee to Mr. Farley has, in part, reimbursed him for his services in the rate case.

The Commission is further of the opinion that the allowed rate case expense of \$2,145 should be amortized over a 3-year period. Therefore, \$715 has been included in test year operating expenses to reflect rate case expenses.

Amortization Expense

During the test period, Third Street employed the engineering firm, Sabak, Wilson, Heiner and Lingo, Inc., to perform a special engineering study related to certain problems within the sewer system. The firm was paid a total of \$2,143 for its services. Mr. Farley testified that this engineering service

should be considered non-recurring. Therefore, the Commission is of the opinion that this non-recurring expense should be amortized over a 3-year period, and has allowed \$715 in test year operating expenses.

Louisville and Jefferson County Board of Health Fee

The annual fee charged by the Louisville and Jefferson County Board of Health to Third Street is \$700.^{5/} The 1982 annual report shows that this operating expense was neither paid nor recorded for the year 1982. Therefore, the Commission has allowed this pro forma operating expense for rate-making purposes.

Jefferson County 2.2 Percent Occupational License Fee

Third Street's recorded expense during the test period for the Jefferson County 2.2 percent occupational license fee was \$266. The Commission has eliminated this tax in this section of the Order and has included the appropriate fee in its determination of revenue requirements.

Therefore, Third Street's adjusted operations at the end of the test period are as follows:

	<u>Third Street Adjusted</u>	<u>Commission Adjustments</u>	<u>Commission Adjusted</u>
Operating Revenues	\$ 45,858	\$ 2,614	\$ 48,472
Operating Expenses	<u>44,141</u>	<u>2,564</u>	<u>46,705</u>
<u>Net Operating Income</u>	<u>\$ 1,717</u>	<u>\$ 50</u>	<u>\$ 1,767</u>

REVENUE REQUIREMENTS

The Commission is of the opinion that Third Street's adjusted operating income is unfair, unjust and unreasonable. The Commission is further of the opinion that operating income of

\$3,000 or an operating ratio of 94 percent is fair, just and reasonable in that no principal repayment must be made from this level of income and that this income provides a fair, just and reasonable return to Third Street's owners given that the owners do not hold title to the assets and thus the only risk inherent to the owners is the safe operation of utility service. Therefore, the Commission finds that Third Street should be permitted to increase its rates to produce an increase in annual revenue of \$1,300^{6/} which includes a Jefferson County 2.2 percent occupational tax of \$67.^{7/}

SURCHARGE

In its application, Third Street requested a surcharge of \$12,000 for major repairs and replacements to its plant to be collected from its 289 customers over a 2-year period. Mr. Farley stated that the original plant assets had been conveyed to Citizens Fidelity Bank through a trust agreement. Furthermore, Mr. Farley attempted to secure a loan of \$12,000 for the repairs from two local banks and was advised that a loan could not be processed without a mortgage on the property of Third Street.^{8/} A mortgage is not possible because of the trust agreement since title to the assets does not belong to Third Street. The AG in its brief has opposed a surcharge.

The record in this case is replete with references to the poor service record of the company. The AG in its brief refers to consumer reports of raw sewage back-up in homes served by Third Street, and further states its concern that repairs to the system are necessary.^{9/}

The Commission's engineering staff, after an inspection and consultation with the Louisville and Jefferson County Health Department, has evaluated both the need for the repairs and the estimated cost of the repairs and has found and reported in the record of evidence that the repairs are indeed necessary and must be made.

The Commission's engineering witness in this case, on cross-examination, stated for the record that the plant could have been maintained better in the past, and that some of the currently needed repairs could be a result of improper past maintenance practices.^{10/} However, no reasonable quantification of the currently necessary repairs that are the result of past neglect can be made, and the plant, which is approximately 20 years old, would, under the best of care, need replacement due to its age.

Third Street's rates are low relative to many other sewer utilities under the Commission's jurisdiction and Third Street has not been before this Commission for general rate relief since 1977. The Commission is gravely concerned, however, with the findings in the past three annual reports on file with the Commission which show that for the years 1979, 1980 and 1981, the current owners of the system had net income from utility operations of \$4,953, \$11,717 and \$4,824, respectively. Dividends declared from these earnings of \$7,010, \$3,500 and \$11,570, respectively, should be more than sufficient to have been reinvested in the company in order to make the necessary repairs to the system that are presently needed and must be made in accordance with requirements by the Department of Health, and the

recommendation of the Commission's engineering staff.

The Commission is thus faced with a difficult decision. It appears from all evidence that the owners and management of the system have not provided adequate maintenance and have moreover had no incentive in the past (possibly due to lack of title and thus no real investment in the plant assets) to reinvest the profits of the system in plant replacement and care.

On the other hand, there are presently insufficient funds in the system to make the repairs, no depreciation expense is allowed nor accumulated, no outside financing is available, and the repairs have to be made in order for the customers of the utility to have adequate, safe and reliable service.

Therefore, the Commission is of the opinion that to allow the surcharge and to monitor the use of these funds closely is the best alternative in this particular case, since the repairs are crucial to the provision of adequate service. The Commission advises the owners that this surcharge procedure implemented herein is an isolated measure and is not a normal rate-making procedure. Thus, the revenues provided to cover normal maintenance expenses should be used entirely for the purposes of replacing and maintaining the plant in an adequate manner.

The Commission is, moreover, of the opinion that all surcharges collected from Third Street's customers should be considered as contributions in aid of construction; thus, Third Street will not be allowed depreciation expense on this plant in the future.

Each class of customer should pay a flat monthly rate. In determining the amount to be paid by each customer class, the Commission analyzed the average test year usage by class and computed the monthly rate based on residential equivalency factors using standard engineering criteria.

Third Street will be required to deposit the monthly surcharges collected from its customers in a special interest bearing account, and to submit a semi-annual report to the Commission which should show a detailed accounting for all receipts, interest earned and disbursements from the special account. The Commission's engineering staff will review the plant operations throughout the 2-year period.

SUMMARY

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

1. The rates proposed by Third Street would produce revenues in excess of the revenues found reasonable herein and should be denied upon application of KRS 278.030.

2. The rates in Appendix A are the fair, just and reasonable rates to charge for sewer service rendered to Third Street's customers and should produce annual revenues of approximately \$49,772.

3. Third Street should be allowed to collect the monthly surcharge in Appendix B for 2 years from the date of this Order or until \$12,000 has been collected.

4. Third Street should be required to establish a special interest bearing account, for the purpose of accumulating a

surcharge of \$6,000 per year for a 2-year period to be collected on each customer's bill, monthly.

5. Third Street should be required to submit a semi-annual report to the Commission setting out the following information:

A. Monthly deposits to the account, identified in Finding No. 4;

B. Interest earnings credited to the account;

C. All disbursements from the account and the recipients thereof;

D. Journal entries recording the transactions in the accounting records of Third Street.

6. Third Street has on file with this Commission a valid third-party beneficiary agreement.

IT IS THEREFORE ORDERED that the rates proposed by Third Street be and they hereby are denied upon application of KRS 278.030.

IT IS FURTHER ORDERED that the rates in Appendix A be and they hereby are the fair, just and reasonable rates of Third Street to be charged for sewer service rendered on and after the date of this Order.

IT IS FURTHER ORDERED that Third Street shall collect the monthly surcharge in Appendix B on and after the date of this Order for 2 years or until \$12,000 has been collected.

IT IS FURTHER ORDERED that Third Street shall establish a special interest bearing account for the purpose of accumulating a surcharge of \$6,000 per year for a 2-year period to be collected monthly from each of its customers, the requirements of which are

set out in Finding No. 5.

IT IS FURTHER ORDERED that, within 30 days of the date of this Order, Third Street shall file with this Commission its tariff sheets setting forth the rates approved herein and a copy of its rules and regulations for providing service.

Done at Frankfort, Kentucky, this 14th day of November, 1983.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary

FOOTNOTES

1. Transcript of Evidence, July 5, 1983, pp. 59-60.
2. LWC printout filed in the Record of Evidence, September 12, 1983.
3. Response to Staff Request dated June 9, 1983.
4. $\$1.72 \times .6817 \times 289 \times 6 = \$2,033 - \$1,738 = \$295.$
5. Response to Staff Request dated March 24, 1983.
6. $\$46,772 \div 94 \text{ percent} = \$49,760 - \$48,472 = \$1,300.$
7. $(\$49,772 - \$46,705) \times 2.2 \text{ percent} = \$67.$
8. Transcript of Evidence, July 5, 1983, p. 117.
9. AG's Brief filed August 19, 1983.
10. Transcript of Evidence, July 5, 1983, p. 19.

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 8783 DATED NOVEMBER 14, 1983

The following rates are prescribed for the customers in the area served by Third Street Sanitation, 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 effective date of this Order.

Rates: Monthly

Single Family Residential	\$9.10
Commercial	2.60 per 1,000 gallons
4-Plex Apartments	29.55 per building

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 8783 DATED NOVEMBER 14, 1983

The following surcharges are prescribed for the customers in the area served by Third Street Sanitation, 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 this Commission prior to the date of this Order.

Third Street shall be allowed to collect the monthly surcharge for two years from the date of this Order or until \$12,000 has been collected.

Surcharge

Single Family Residential	\$ 1.39 per month
4-Plex Apartments per building	3.68 per month
Valley View Baptist Church	9.73 per month
Valley View Baptist Ball Park	1.39 per month
Windsor Health Center	22.24 per month