

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF WOODLAND ACRES)
SANITATION, INC., FOR A CERTIFICATE)
OF PUBLIC CONVENIENCE AND NECESSITY)
FOR THE CONSTRUCTION OF A SEWAGE) CASE NO. 8989
TREATMENT PLANT IN BULLITT COUNTY,)
KENTUCKY, FOR APPROVAL OF INITIAL)
RATES AND FOR APPROVAL OF FINANCING)

O R D E R

Woodland Acres Sanitation, Inc., ("Woodland Acres") filed an application on February 21, 1984, for a certificate of public convenience and necessity authorizing the construction of a 25,000 gallon per day sewage treatment plant and collection system. On May 15, 1984, Woodland Acres amended its application to request approval of initial rates. A third party beneficiary agreement was filed June 18, 1984.

A copy of a Construction Permit from the Natural Resources and Environmental Protection Cabinet for the proposed project is on file with this Commission.

The rates proposed would produce annual revenue of \$36,416 based upon 121 customers. Based on the determination herein, the Commission has granted Woodland Acres rates that will produce annual revenue of \$28,270.

A hearing was held on July 17, 1984, in the offices of the Public Service Commission in Frankfort, Kentucky. At the hearing certain requests for additional information were made. This information has been filed.

TEST PERIOD

This is a proposed rather than an operating utility, and, accordingly, test-year information does not exist. Estimated pro forma expenses have been utilized for the determination of revenue requirements.

PROJECTED REVENUES AND EXPENSES

Woodland Acres projected operating expenses on the basis of providing service to 121 residential customers. The Commission is of the opinion that the projected operating expenses generally are proper and they have, therefore, been accepted with the following modifications:

Management Fee

Woodland Acres proposed a management fee of \$4,800 according to its amended application of May 15, 1984. However, at the hearing of July 17, 1984, Woodland Acres stated that the manager's fee will be \$1,800, while the remaining \$3,000 will be paid to a daily operator.¹

Woodland Acres has contracted with a service company for provision of routine maintenance of the sewage treatment plant and collection system at an annual cost of \$4,000. Thus, the Commission is of the opinion that there is no need to employ a daily operator for services which are to be provided by the service company. Furthermore, the day-to-day operation of the utility should be the responsibility of the

¹ Transcript of Evidence, July 17, 1984, p. 13.

manager. Therefore, the Commission has allowed \$1,800 as the total compensation for the management fee.

Bookkeeping Services

Woodland Acres has proposed an annual expense of \$3,000 for bookkeeping services. Since billing will be done by Louisville Water Company, the Commission is of the opinion that \$100 per month should be an adequate allowance for bookkeeping. In arriving at this amount, the Commission has taken into consideration bookkeeping expenses for similar-sized utilities. Therefore, the Commission has included \$1,200 as the annual cost of bookkeeping services for rate-making purposes.

Legal Expense

Woodland Acres proposed an annual legal expense of \$800. According to the amended application of May 15, 1984, \$500 of the \$800 is a non-recurring legal expense which is the result of the rate case before this Commission. Essentially, Woodland Acres has proposed to amortize the rate-case legal expense over a 2-year period. However, in this instance, the Commission is of the opinion that a more reasonable amortization period would be 3 years. Therefore, the Commission has allowed a legal expense in the amount of \$633.

Payroll Taxes

Woodland Acres proposed a payroll tax expense of \$504. This is based on a social security rate of 7 percent and an unemployment tax rate of 3.5 percent applied to \$4,800, the amount proposed by Woodland Acres as a management fee. As

explained previously, the Commission has disallowed \$3,000 of the \$4,800. The remaining \$1,800, which represents the manager's salary, is not generally subject to payroll taxes inasmuch as this amount would be reported as self-employment income by the manager. The Commission generally allows \$1,800 as the total compensation for the manager's fees. Therefore, no provision for payroll taxes has been allowed herein.

Interest Expense

Woodland Acres proposed interest expense of \$1,164 on loans advanced from its parent company, Big Star Land Company. However, Woodland Acres has agreed to subsidize the operation of the sewage treatment plant until it can become self-supporting. Furthermore, it is the policy of the Commission not to allow, for rate-making purposes, interest expense on debt incurred to subsidize operating losses. Therefore, the Commission has determined that the entire amount of interest expense should be disallowed.

In its application, Woodland Acres projected operating expenses, exclusive of depreciation, of \$31,513. After the adjustments made by the Commission herein, the pro forma operating expenses found reasonable amount to \$24,878. In allowing this level of operating expenses, the Commission recognizes that most of the costs are estimates and actual costs may vary. The resulting rate, based on this level of expense, is high in comparison to many small privately-owned sewer utilities. Therefore, Woodland Acres should try to

minimize costs to the fullest extent possible and, if possible, attempt to reduce rates when the system achieves full capacity. The Commission will monitor costs and expenses and will examine the reasonableness of the rates of Woodland Acres when the system achieves full capacity.

REVENUE REQUIREMENTS

The Commission is of the opinion that the operating ratio² 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 Woodland Acres to pay its operating expenses and provide a reasonable return to its owners. Therefore, the Commission finds that Woodland Acres is entitled to establish rates to produce total annual revenue of \$28,270.

FINDINGS AND ORDERS

Based on the evidence of record, the Commission is of the opinion and finds that:

1. Public convenience and necessity require that the construction proposed in the application be performed and that a certificate of public convenience and necessity be granted.

2. The construction project proposed by Woodland Acres consists of a sewage collection system and a 25,000

² Operating Ratio = $\frac{\text{Operating Expenses}}{\text{Gross Revenue}}$

gallon per day sewage treatment plant to provide sewage service for a proposed subdivision consisting of 121 single-family residential units.

3. Any deviations from the construction drawings and specifications herein approved which could adversely affect service to any customer should be subject to the prior approval of this Commission.

4. The total cost of the construction project is estimated to be \$164,938, which will be recouped by Woodland Acres at such time as all 121 lots of the proposed development have been sold.

5. The proposed initial rate is inadequate at this time to produce the revenue required to meet Woodland Acres' operating expenses and provide for sufficient capital growth.

6. The rates proposed by Woodland Acres are promotional in nature.

7. A utility formed by real estate developers should not request initial rates which are insufficient to meet its anticipated operating requirements. Moreover, inadequate initial rates are unfair to the purchasers of the developed lots who expect to pay low sewage fees for a period of time longer than these rates are usually in effect.

8. Woodland Acres represented to the Commission that it will subsidize any shortfall of operating revenue until the subdivision can become self-supporting. The granting of a certificate of public convenience and necessity and approval of the rates herein are expressly conditioned on the

performance by Woodland Acres of such undertaking, and further, on full written disclosure by Woodland Acres to its customers that rates may not reflect all the costs of operation of the treatment system. The disclosure shall be made before such customers have committed themselves to purchase property to be served by the system, and shall be in substantially the following form:

The current rate for sewage disposal services for the subdivision is not sufficient to cover operating expenses without a subsidy from the developer. If this development does not continue as anticipated, your rate may increase substantially in the near future.

9. The Commission is of the opinion that the initial customers should not pay for excess plant capacity and that the initial rate should be based on the total plant capacity. The rate in Appendix A is based on plant capacity of 121 customers and is the fair, just and reasonable rate to be charged by Woodland Acres.

10. The rate proposed by Woodland Acres would produce revenue in excess of that found reasonable herein and should be denied.

11. Woodland Acres has filed with the Public Service Commission a valid third-party beneficiary agreement as a part of its application.

12. Woodland Acres should furnish duly verified documentation of the total cost of this project including the cost of construction and all other capitalized costs (engineering, legal, administrative, etc.) within 60 days of the

date that construction is substantially completed. Said construction costs should be classified into appropriate plant accounts in accordance with the Uniform System of Accounts for Sewer Utilities prescribed by this Commission.

13. Woodland Acres should furnish to the Commission a copy of the "as-built" drawings and a signed statement that the construction has been satisfactorily completed in accordance with the contract plans and specifications within 60 days of the date of substantial completion of this construction.

IT IS THEREFORE ORDERED that Woodland Acres be and it hereby is granted a certificate of public convenience and necessity to proceed with the construction of the sewage treatment and collection system set forth in the drawings and specifications herein approved.

IT IS FURTHER ORDERED that Woodland Acres be and it hereby is granted a certificate of public convenience and necessity to operate this sewer system.

IT IS FURTHER ORDERED that the rate in Appendix A is hereby fixed as the fair, just and reasonable rate to be charged by Woodland Acres for sewer service rendered on and after the date of this Order.

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

IT IS FURTHER ORDERED that Woodland Acres be and it hereby is directed to abide by the conditions in Finding No. 8. In addition, Woodland Acres shall furnish to the

Commission on a quarterly basis, as required, written acknowledgement of notice from each prospective customer as contained in Appendix B to this Order.

IT IS FURTHER ORDERED that Woodland Acres shall file its tariff sheets setting forth the rate approved herein within 20 days of the date of this Order.

IT IS FURTHER ORDERED that Woodland Acres shall file with the Commission duly verified documentation which shows the total costs of the construction herein certificated including all capitalized costs (engineering, legal, administrative, etc.) within 60 days of the date that construction is substantially completed. Said construction costs shall be classified into appropriate plant accounts in accordance with the Uniform System of Accounts for Sewer Utilities prescribed by this Commission.

IT IS FURTHER ORDERED that Woodland Acres shall furnish this Commission with "as-built" drawings and a signed statement that the construction has been satisfactorily completed and has been done in accordance with the contract plans and specifications within 60 days of the date of substantial completion of the proposed construction.

Done at Frankfort, Kentucky, this 31st day of August, 1984.

PUBLIC SERVICE COMMISSION

Richard D. Hemmick
Chairman

Robert L. ...
Vice Chairman

James ...
Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 8989 DATED AUGUST 31, 1984

The following rate is prescribed for the customers in the area served by Woodland Acres Sanitation, Inc., located in Bullitt County, Kentucky.

RATE: Monthly

Single Family Residential

\$19.47

APPENDIX B

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION IN CASE NO. 8989 DATED AUGUST 31, 1984

I have read and fully understand the following:

The current rate for sewage disposal services for the subdivision is not sufficient to cover operating expenses without a subsidy from the developer. If this development does not continue as anticipated, my rate may increase substantially in the near future.

Customer's Signature

Address

Date