

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF MULBERRY)
ENTERPRISES, INC., FOR ADJUSTMENT)
OF RATES PURSUANT TO THE) CASE NO. 9469
ALTERNATIVE PROCEDURE FOR SMALL)
UTILITIES)

O R D E R

On November 25, 1985, Mulberry Enterprises, Inc., ("Mulberry") filed an application with the Commission to increase its sewer rate pursuant to 807 KAR 5:076, Alternative Rate Adjustment Procedure for Small Utilities ("ARF"), requesting additional operating revenues of approximately \$12,909 annually, an increase of 40.4 percent over reported test-period operating revenues. Mulberry is a privately-owned sewage treatment plant providing service to approximately 185 residential customers in Franklin County, Kentucky. A hearing was not requested in this matter and, in accordance with the provisions of the ARF, no hearing was conducted.

On March 12, 1986, the Utility and Rate Intervention Division, Office of the Attorney General ("AG") filed with the Commission a motion to dismiss or in the alternative that the application be deemed filed as of February 25, 1986, not November 25, 1986.

The Commission held a public meeting on the evening of May 5, 1986, to afford Mulberry's customers an opportunity to comment.

Prior to the meeting, the Commission had received one individual consumer letter and two petitions containing 110 signatures opposing Mulberry's request for a higher sewer rate. Raymond Solomon, a Mulberry customer, was granted limited intervention status by the Commission's Order entered March 14, 1986, and the AG also intervened in this case.

TEST PERIOD

Mulberry proposed the 12-month period ending December 31, 1984, as the test period for determining the reasonableness of the proposed rates.

To simplify the regulatory process for this small utility, the Commission staff performed a limited financial audit for the utility's test period to verify reported expenditures and substantiate the propriety of the test-year financial statements. Based upon the findings contained in the staff audit report of Mulberry dated February 20, 1986, the Commission has made the following adjustments to reported test-year operating expenses:

	<u>1984 Actual Per Annual Report</u>	<u>Adjustments</u>	<u>Test Year Per Staff Audit</u>
Operating Revenues	\$31,991	\$ -0-	\$31,991
Operating Expenses	<u>36,637</u>	<u><430></u>	<u>36,207</u>
Operating Income	\$<4,646>	430	\$<4,216>
Other Income	54	-0-	54
Interest on Long-Term Debt	<u>1,924</u>	<u>-0-</u>	<u>1,924</u>
NET INCOME	<u>\$<6,516></u>	<u>\$ 430</u>	<u>\$<6,086></u>

ADJUSTMENTS TO EXPENSES FOR RATE-MAKING PURPOSES

The Commission has made, for rate-making purposes, the following modifications to Mulberry's test-period expenses, as

adjusted in the staff audit report, to reflect more normal and current operating conditions:

Sludge Hauling Expense

Mulberry proposed an adjustment to increase test-year sludge hauling expense of \$50 by \$450. In response to Item No. 3 of the Commission's Information Request of February 13, 1986, Mulberry stated that the proposed adjustment to sludge hauling expense was an estimate based on new effluent standards and that no documented evidence was available. Therefore, since Mulberry has presented no documentation to support its proposed adjustment, test-year actual sludge hauling expense has been included for rate-making purposes.

Labor Costs

Mulberry reported test year charges of \$17,450 to Account No. 701-C--Other-Labor Materials and Expenses and also proposed an adjustment to increase this amount by \$1,200. Mulberry stated that the proposed adjustment was due to certain maintenance requirements for which Paul Mulberry, the owner, had not billed the utility in the past. Mulberry provided no documentation in support of this adjustment.

As explained in the staff audit report which was made a part of the record in this case by the Commission's Order of February 20, 1986, all but \$20 of the \$17,450 represents test year wages for Paul Mulberry, who provided maintenance services. An examination of test-year cancelled checks revealed that 26 checks for contract labor were paid to Paul Mulberry for a total of \$11,140. An additional \$6,290 for service contract fees was

accrued during the test year. The amount of \$11,160 actually paid for maintenance services during the test year represents an increase of 13.9 percent over total charges (both paid out and accrued) of \$9,800 to the same account during the preceding year. Furthermore, total test-year charges of \$17,450 represent an increase of 78 percent over the \$9,800 charged to that account during 1983.

In support of test-year wages for Paul Mulberry, Mulberry provided a calendar on which he recorded the number of hours worked at the sewage treatment plants daily. Entries showed only the number of hours worked on a given day with no details as to what was done.

An analysis of the calendar kept by Paul Mulberry showed that he went to the plants 24 days per month on the average and worked an average of approximately 5 3/4 hours on each of those days. In Item No. 4 of the Commission's Information Request of February 13, 1986, Mulberry was asked to provide the duties performed on a routine day along with a breakdown of the approximate time required for each duty, evidence as to why an average of 5 3/4 hours is required on a daily basis, and whether alternatives to having Paul Mulberry perform routine maintenance services had been considered. In response, Mulberry provided a list of duties, some of which may be performed daily. A breakdown of the approximate time required for each duty was not provided. Mulberry stated that Paul Mulberry had considered contracting with another organization for routine maintenance services, but provided no evidence that bids had been taken.

The Commission is concerned with the escalation of prices customers must pay for utility services. On the other hand, it is also aware that costs to utilities to provide services have increased and that utilities should be allowed a reasonable level of expense. In this instance, an increase in test-year labor costs of 78 percent over that for the previous year is not reasonable. Therefore, the Commission has allowed charges of \$11,160, the amount actually paid for maintenance services during the test year, for rate-making purposes. As mentioned previously in this section, Mulberry provided no documentation to support its proposed adjustment to increase labor by \$1,200 and it has thus been excluded for rate-making purposes.

Maintenance of Treatment Plant

Mulberry proposed an adjustment of \$653 to Account No. 714-- Maintenance of Treatment and Disposal Plant, stating that the utility replaced a blower motor at a cost of \$1,020. In support of its proposed adjustment, Mulberry filed a copy of the invoice, paid by check number 435 on January 7, 1985. Although the disbursement was made outside the test year, it is known and measurable. However, the expenditure for the blower motor should be capitalized rather than expensed. Therefore, the proposed adjustment has been excluded and the actual test-year amount of \$574, per the staff audit report, has been included for rate-making purposes.

Agency Collection Fee

Mulberry proposed an adjustment to increase the test-year agency collection fee of \$4,799 by \$1,936. The adjustment

represents 15 percent of the additional revenue requested by Mulberry in its application. Under contract, Farmdale Water District ("District") provides billing and collecting services for Mulberry at a flat rate of 15 percent of sewer fees collected. For the test year, the collection fee paid to the District averaged \$400 per month. The Commission is of the opinion that Mulberry should seek a more economical means for the provision of collecting and billing services. According to Mulberry's annual report, the number of customers averaged 185 during the test year. Since each customer was billed a flat rate of \$14.25 per month, no calculations had to be made. Therefore, invoices could have been identical and should require very little time to produce.

In Case No. 8102, The Application and Petition of the Farmdale Development Corporation, Inc., for an Order Authorizing Said Corporation to Revise Rates, collection fees paid to the District was also an issue. Farmdale Development Corporation, Inc., ("Farmdale") a sewer utility, was under a contract agreement with the District to pay a flat rate of 15 percent of sewer fees collected for collecting and billing services. During the course of its investigation in that case, the Commission made a random survey of the customer accounting and collecting costs of 40 of the 219 sewer utilities under its jurisdiction. The average monthly cost per customer was determined to be approximately 84¢. The Commission allowed Farmdale a monthly charge of \$1 per customer.

In recognition of rising prices, the Commission has adjusted the average cost of 84¢ per month at September 1981, by the change

in the Consumer Price Index-U to reflect the cost at the end of the test year in this case. The result is an average cost of 95¢ per month. Applying the same return allowed to Farmdale, Mulberry would be allowed a charge of \$1.13 monthly per customer. The Commission is of the opinion that the allowance of \$1.15 per customer per month is a fair amount to be charged to the rate-payers and represents a cost reduction achievable by Mulberry. Therefore, an agency collection fee of \$2,553¹ has been included for rate-making purposes. The Commission reiterates that Mulberry should seek to acquire more economical means of monthly billings, either through negotiation with Farmdale, seeking services of other billing companies or preparing and collecting bills within the company.

Outside Services Employed

Mulberry proposed an adjustment of \$842 to test year charges of \$1,357 to Account No. 923--Outside Services Employed. Four hundred dollars of the adjustment is related to water-testing expense. Mulberry stated that the proposed increase is due to more stringent particulate emission standards promulgated by the Kentucky Natural Resources Cabinet. Mulberry provided no documentation of increased cost.

In support of its proposed adjustment to accounting expense, Mulberry provided copies of two invoices from its accountant. One invoice was for test year services that were not billed until 1985. The invoice shows charges of \$939 as compared to test year

¹ \$1.15 X 185 customers X 12 months = \$2,553.

charges of \$757 for accounting. The second invoice was for accounting services related to this rate case. This will be addressed in a subsequent section.

Mulberry's proposed increase to water-testing expense is not known and measurable and has been excluded for rate-making purposes, but an increase of \$182 to test-year accounting expense has been included and total charges of \$1,539 to Outside Services Employed have been allowed for rate-making purposes.

Depreciation Expense

Mulberry reported test-year depreciation expense of \$2,337. As explained in the staff audit report, this amount was subsequently adjusted to \$2,079 for bookkeeping purposes.

On December 14, 1981, County Wide Rentals, Inc., ("County Wide") filed a joint application in Case No. 8408, with Mulberry petitioning the Commission to allow the sale by County Wide to Mulberry of three sewage treatment plants. The Commission's Order of April 20, 1982, allowed the proposed sale in accordance with terms set forth in the Contract and Bill of Sale dated December 21, 1981. In that Order, the Commission found that County Wide had recovered the cost of two of the three sewage treatment plants through the sale of lots.

During the hearing of February 17, 1982, in Case No. 8408, the Commission sought to determine the original cost of the three treatment plants. When that information was not provided, the Commission requested that it be provided by February 28, 1982. In a response filed April 1, 1982, County Wide and Mulberry stated

jointly that neither they nor their accountant had been able to locate that information.

The Commission's finding that County Wide had recovered the cost of two of the three treatment plants was based on the testimony of Robert Bass, CPA, who appeared at the hearing of February 17, 1982, on behalf of County Wide and Mulberry. However, there is no information in the record in Case No. 8408 which indicates the level of investment recovered by County Wide through the sale of lots. County Wide's 1981 Annual Report shows nothing in Account No. 271--Contributions in Aid of Construction.

In several cases, including Case No. 8193, The Amended Application of Orchard Grass Sanitation, Inc., for an Order Pursuant to Chapter 278 of the Kentucky Revised Statutes Authorizing an Adjustment in Rates for the Existing Sewage Treatment Plant Serving Orchard Grass Hills Subdivision, Oldham County, Kentucky, and Case No. 9503, The Application of Nottingham Sanitation, Inc., for an Adjustment of Rates Pursuant to the Alternative Rate Procedure for Small Utilities, the Commission has taken the position that developers required to provide sewage treatment facilities for customers fully intend to recover the cost of such facilities through the sale of lots.

In this case, because of the poor or non-existent records of the previous owners, no documentation has been provided to support the original cost of plant-in-service. Furthermore, as mentioned previously, the level of contributions realized through the sale of lots is unknown. In the absence of such vital information, the Commission takes the position that the cost of the original plants

was recovered by the original owners through the sale of lots or through depreciation of the assets. However, if the original cost of the plant and contributions in aid of construction are documented to the Commission's satisfaction, its position may be modified accordingly. Presently, the Commission will not allow depreciation on plant transferred to Mulberry.

Since the acquisition of the treatment plants by Mulberry, plant additions of \$699 were made during 1983 and 1984. Applying County Wide's composite depreciation rate for 1981 to these additions results in annual depreciation expense of \$51.² Also, as explained in the staff audit report, Mulberry expensed some items during the test year which should have been capitalized. Those items totaled \$460 and annual depreciation expense, based on the straight-line method over an estimated service life of 5 years, comes to \$92. The resulting annual depreciation expense included herein for rate-making purposes is \$143.

Rate Case Expense

Mulberry proposed no adjustment to allow for rate case expense as such. However, in support of its proposed adjustment to Account No. 923--Outside Services Employed, a copy of an invoice for \$225 was submitted. The invoice was for accounting services relative to this rate case. The Commission is of the opinion that such expenses should be amortized over a period of 3

² Composite Depreciation Rate = $\frac{\text{Depreciation Expense}}{\text{Gross Plant-In-Service}}$

$$\$1,192 \div \$16,485 = 7.23\%, 7.23\% \times \$699 = \$51.$$

years and has included rate case expense of \$75 for rate-making purposes.

Interest Expense on Long-Term Debt

Mulberry proposed an adjustment to reduce test-year interest expense on long-term debt by \$127 due to the normal decrease in interest on notes payable as principal is amortized.

As explained previously in the section on depreciation expense, the Commission has taken the position that the cost of the original plants was recovered by the original owners through the sale of lots or through depreciation of the assets. Therefore, as recovery of its investment was realized by the original owners, the Commission is of the opinion that the debt associated with the treatment plants could have been retired.

If the present owner of the plants had assumed debt associated with upgrading and/or expansion of the original facilities, interest expense may be allowed for rate-making purposes. However, there is no evidence that this has occurred. Mulberry has not provided the Commission with the original cost of the treatment plants as requested. Furthermore, Mulberry has not had a case before the Commission in which it requested authority to construct additional plant and approval of a plan of financing. To the Commission's knowledge, Mulberry's notes payable are associated with either the original cost of the plants or purchase of the plants from County Wide at a cost above book value. Therefore, the Commission has not included, for rate-making purposes, test-year interest expense on long-term debt associated

with the treatment plants, the cost of which was recovered through lot sales or depreciation of the assets.

After consideration of the aforementioned adjustments, the Commission finds Mulberry's test period operations to be as follows:

	<u>Test Period Per Staff Audit Report</u>	<u>Commission Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$31,991	\$ -0-	\$31,991
Operating Expenses	36,207	<8,594>	27,613
Net Operating Income	<u><\$4,216></u>	<u>\$ 8,594</u>	<u>\$ 4,378</u>
Other Income	54	-0-	54
Other Deductions	<u>1,924</u>	<u><1,924></u>	<u>-0-</u>
NET INCOME	<u><u><\$6,086></u></u>	<u><u>\$10,518</u></u>	<u><u>\$ 4,432</u></u>

REVENUE REQUIREMENTS

Mulberry has not had a previous rate case before the Commission. However, while the three treatment plants were operated by the previous owners as County Wide, two rate cases were heard by the Commission. In County Wide's last rate case, Case No. 7781, The Application of Petition of County Wide Rentals, Inc., to Revise Rates, the Commission allowed an operating ratio of .88. In this case, the Commission finds that an operating ratio of 88 percent is fair, just and reasonable and will allow Mulberry to pay its operating expenses, service its debt, and provide a reasonable return to its owners.

In this instance the use of an 88 percent after-tax operating ratio applied to the adjusted test-year operating expenses results in a revenue requirement of \$31,324 which is less than the actual test-period revenues. Therefore, the Commission finds that no

deficiency exists in the revenues of Mulberry and has, therefore, allowed no increase in revenues.

MOTION TO DISMISS

The AG cited Mulberry's failure to comply with KRS 278.185, requiring notice to sewer customers of rate change applications, since Mulberry did not notify its customers when it initially filed its case. Notice was not given until February 25, 1985.

In light of the Commission's determination that no rate increase shall be granted to Mulberry, the AG's Motion to Dismiss is moot.

SUMMARY

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

1. The rate proposed by Mulberry should be denied.

IT IS THEREFORE ORDERED that:

1. The rate proposed by Mulberry is denied.
2. The rate currently charged by Mulberry shall remain in effect.
3. The AG's Motion to Dismiss is denied as moot.

Done at Frankfort, Kentucky, this 20th day of June, 1986.

PUBLIC SERVICE COMMISSION

Richard D. Womack
Chairman

Robert L. ...
Vice Chairman

James N. Williams
Commissioner

ATTEST:

Secretary