

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION FOR THE TRANSFER OF)
OWNERSHIP OF A & B SANITATION COMPANY,)
INC., AND FOR A RATE ADJUSTMENT PURSUANT) CASE NO. 10391
TO THE ALTERNATIVE RATE FILING PROCEDURE)
FOR SMALL UTILITIES)

O R D E R

PROCEDURE

On September 22, 1988, A & B Sanitation Company, Inc. ("A & B"), formerly Angle-Begley Development, Inc. applied for approval of the transfer of ownership of its capital stock to Bil Darby and for approval of a rate increase pursuant to Commission Regulation 807 KAR 5:076. The proposed rate increase would produce additional revenues of \$17,085 annually, an increase of 61.16 percent. The Commission has previously dealt with the transfer of ownership.¹ This Order grants an increase in total operating revenues of \$9,394 or 36 percent.

Although A & B filed its application on September 22, 1988, it was not considered as filed until November 7, 1988 when the utility published notice of its proposed increase to its customers. 807 KAR 5:076, Section 3; 807 KAR 5:011, Section 9(2). The Commission suspended the proposed rate for 5 months in order to conduct an investigation into the reasonableness of the

¹ Commission Order of March 30, 1989.

proposed rate. On July 1, 1989, A & B placed its proposed rate into effect subject to refund.

The following parties have been permitted to intervene in this proceeding: the Utility and Rate Intervention Division of the Office of the Attorney General ("AG"),² and Marcella Hayden, George Slone and Sonja R. Slone - customers of A & B.³ Hearings in this case were held in the Commission's offices in Frankfort, Kentucky on February 16 and August 7, 1989. At these hearings, the Commission heard testimony from Mr. Darby, Ms. Slone, Malcolm Wasson - an independent contractor for A & B, and Commission Staff members Angela Martin and Kevin Mason.

DISCUSSION

Test-year

In its application, A & B proposed to use the 1985 calendar year as its test-year. In support of its proposal, A & B contended that the 1985 calendar year was the last year for which accurate data was available. It was the last year for which A & B had filed an annual report with the Commission. In 1986, A & B petitioned for relief under Chapter 7 of the Bankruptcy Code and, as a result, did not file an annual report for the 1986 or 1987 calendar years. In further support of its proposed test-year,

² The AG did not formally move for leave to intervene in this proceeding. Commission Regulation 807 KAR 5:076, Section 5 provides that the AG will be deemed an intervenor in all alternative rate adjustment proceedings without making application therefor.

³ Theresa Payton, another A & B customer, was also permitted to intervene in this proceeding, but subsequently withdrew.

A & B asserted that when ownership of the utility changed hands in February 1988 the prior owner refused to surrender the utility's financial records. Therefore, the current owners of the utility lacked more recent information upon which to base a test-year.

The Commission was able to obtain A & B's financial records for 1987 from its prior owner. As these records are now available and as 1987 is closer in time to the present, the Commission believes that the 1987 calendar year is the more appropriate year to use as the test-year.

Operating Revenue

Kevin Mason prepared a billing analysis for the test-year period. He testified that the result of his analysis showed that the existing rates produced test-year revenue in the amount of \$26,080.⁴ The intervenors have questioned the accuracy of this analysis, maintaining that it understates the number of A & B's customers. The Commission's review of A & B's records supports Mr. Mason's finding.

Operating Expenses

Angela Martin testified at the August 7, 1989 hearing that her review of the A & B's financial records showed that A & B's actual test-year expenses totaled \$27,620.⁵ As Ms. Martin's

4	Test-year Customers	211 x 12 =	\$2,532
	Present Rate		x \$10.30
	Normalized Revenue		<u>\$ 26,080</u>

5 Amended Staff Report, May 15, 1989, page 6. (Adopted by Ms. Martin as her testimony at the August 7, 1989 hearing). See Transcript of Evidence, August 7, 1989 Hearing, page 174.

testimony is controverted on this point, the Commission finds that A & B's actual test-year expenses were \$27,620. It further finds that the following adjustments are warranted:

Purchase Power and Water Expense. A & B's actual purchase power and water expense for the test period was \$6,485. This expense includes \$463 in penalties incurred for late payment. As these penalties are a direct result of management's actions, the Commission is of the opinion that they should not be allowed for rate-making purposes. Accordingly, the test-year purchase power and water expense has been decreased by \$463.

Routine Maintenance Expense. Test-year records indicate that A & B's routine maintenance expense is \$3,928. This expense includes payments to Mr. Darryl Angle, the former owner of A & B, totalling \$1,725. The Commission is of the opinion that these payments should be excluded for rate-making purposes since they represent owner/manager compensation for services provided. The allowed owner/manager fee is discussed in another section of this Order. Therefore, test-year routine maintenance expense has been decreased to \$2,203.

Office Rent, Utilities, and Telephone Expense. The office rent, utilities, and telephone expenses during the test-period totalled \$2,814. In its application, A & B proposed to decrease this expense to \$1,710 to reflect the fact that A & B's offices are now located in Mr. Darby's home. Mr. Darby has since indicated that he is relocating A & B's offices and he has submitted five written estimates for office space and related expenses. At the August 1989 hearing, Mr. Darby testified that he

has chosen the most economical office space which costs \$395 per month plus utilities.⁶ As the office space would be used not only by A & B, but also by E.P. Sanitation Co., Inc. ("E.P."), another sewage utility owned by him, Mr. Darby proposed to allocate the costs equally between each utility.

At the August 1989 hearing, the AG asserted that Mr. Darby's choice was not the most economical and provided a newspaper advertisement for office space at a monthly rental rate of \$235, which included some utility service.⁷ In response, Mr. Darby stated that other factors, such as security and location are also important.⁸

The Commission agrees that other factors must be considered. Furthermore, based upon the number of written estimates provided, the Commission finds that A & B's proposed office rent and related expenses are reasonable. Therefore, given the monthly utilities and telephone estimates of \$70 and \$54, respectively, and dividing the costs equally between A & B and E.P., the Commission is of the opinion that the test-year rent expense of \$2,814 should be increased by \$300.

Test Expense. During the test-year, A & B incurred only \$165 in testing expenses. At the August 1989 hearing, Mr. Darby testified that the previous owner of A & B failed to conduct

⁶ Transcript of Evidence, August 7, 1989 Hearing, page 116.

⁷ Id. at 134.

⁸ Id. at 134-135.

proper testing of the sewage treatment plant's effluent.⁹ Mr. Darby further stated that testing of the effluent was required on a monthly basis. A & B has proposed an increase to its testing expense and has provided several written estimates in support of its proposal. Mr. Darby testified that he prefers to use the services of Commonwealth Technology, which submitted one of the lowest estimates.¹⁰

The Commission is of the opinion that, based upon Commonwealth Technology's estimate of \$77 per month, the test-year testing expense should be increased to \$924.

Property Taxes and License Expense. During the test-year, A & B paid approximately \$104 for property taxes. During 1988, the following calendar year, A & B paid the following taxes and fees:

Kentucky State Treasurer	\$ 96
Madison County Sheriff	141
PSC Fee	50
	<u>\$287</u>

Based upon these 1988 taxes and fees, the Commission finds that test-year property taxes and license fees should be increased from \$104 to \$287.

Taxes Other Than Income Tax. Based upon the test-year financial records, payroll taxes totalled \$1,308. Given the actual test-year wages of \$7,403, the normal employer expense for

⁹ Id. at 151.

¹⁰ Id. at 86.

such taxes should be \$834.¹¹ Accordingly, the Commission finds that this expense should be decreased by \$474.

Insurance Expense. A & B proposed to increase the test-year operating expenses to include a provision for insurance. Given that no insurance coverage was provided during the test-year and based upon the least expensive insurance quote provided by Berea Insurance Agency, the Commission is of the opinion and finds that the test-year operating expenses should be increased by \$1,077.

Sludge Hauling Expense. A & B proposed to increase test-year operating expenses to provide for sludge hauling. During 1988 four loads of sludge were hauled at a total cost of \$500. As no sludge was hauled during the test-year and since this is a recurring expense, the Commission is of the opinion and finds that the test-year operating expenses should be increased by \$500.

Owner/Manager Fee. During the test period, A & B expensed payments totalling \$1,725 to Darryl Angle, then its sole shareholder, for services provided. A & B proposed in its application an \$1,800 annual owner/manager fee to compensate its current sole shareholder, Mr. Darby, for his management services. Since filing the application, A & B has sought a larger sum to

11 FICA: \$7,403 x .0751	= \$556
State Unemployment:	
\$7,403 x .03	= 222
Federal Unemployment	
(Limited to \$7,000):	
\$7,000 x .008	= 56
	<u>\$834</u>

compensate Mr. Darby. The Commission is of the opinion that an \$1,800 owner/manager fee is, as a general rule, the appropriate amount of compensation for the management services provided to small package sewer treatment facilities. While it will consider higher amounts when appropriate, the applicant must present substantial evidence that the services which he provides are of an extraordinary level. A & B has presented no such evidence. Accordingly, the Commission finds that A & B's test-year operating expenses be increased by \$1,800 for the proposed owner/manager fee.

Proposed Adjustments Not Considered. During the course of this case, A & B has proposed adjustments not contained in its original application. A & B was repeatedly advised by the Commission, through Staff, that its proposed adjustments must be accompanied by supporting documentation. In several instances, A & B's owner was advised that specific items of evidence were required. While some of the evidence submitted is sufficiently definite to be considered by the Commission, much of it was too general, vague and speculative in nature to be accorded any weight or to meet the Commission's rate-making criteria of being known and measurable.

In this regard, the Commission notes that its responsibility is to determine a reasonable rate based solely upon the evidence of record. The applicant for a rate adjustment bears the sole responsibility for preparing the application and presenting evidence in support of its requested adjustment to show that it will produce fair, just, and reasonable rates.

Summary

The Commission has determined A & B's operating statement to be as follows:

	<u>Test-year Actual</u>	<u>Adjustments</u>	<u>Test-year Adjusted</u>
Operating Revenues	<u>\$26,080</u>	<u> </u>	<u>\$26,080</u>
Operating Expenses			
Purchase Power and			
Water Expense	\$ 6,485	\$ <463>	\$ 6,022
Administrative Wages	7,403		7,403
Office Supplies	646		
Routine Maintenance	3,928	<1,725>	2,203
Repair & Maintenance	3,612		3,612
Professional Services	1,155		1,155
Office Rent & Telephone	2,814	300	3,114
Testing	165	759	924
Property Taxes			
and Licenses	104	183	287
Taxes Other than			
Income Taxes	1,308	<474>	834
Sludge Hauling		500	500
Owner/Manager Fee		1,800	1,800
Depreciation and			
Amortization		<u>680</u>	<u>680</u>
Total	<u>\$27,620</u>	<u>\$2,637</u>	<u>\$30,257</u>
Net Operating Income			
Exclusive of Provision			
for Income Taxes	<u>\$<1,540></u>	<u>\$<2,637></u>	<u>\$<4,177></u>

Revenue Requirements Determination

The approach frequently used by the Commission to determine revenue requirements for small, privately-owned utilities is the calculation of an operating ratio. This approach is used primarily when there is no basis for a rate-of-return determination or due to the fact that the cost of the utility

plant has fully, or largely, been recovered through the receipt of contributions, either in the form of grants or donated property.

The Commission has determined that A & B needs additional annual operating income of \$9,394 based upon an 88 percent operating ratio.¹² An 88 percent operating ratio should result in a net cash flow of \$4,257¹³ and provide sufficient operating revenues for A & B to meet its operating expenses and provide for reasonable equity growth in the future.

Future Monitoring

Due to the recent change in ownership and the resulting change in operations, the Commission advises A & B to closely monitor its financial position. In addition, should the rate authorized herein become insufficient to meet the operating expenses and needed equity growth, A & B should initiate the appropriate measures to alleviate the difficulty.

¹²	Adjusted Operating Expenses	\$30,257
	Provision for Income Taxes	960
		<u>\$31,217</u>
	Operating Ratio	+ .88
	Revenue Requirements	<u>\$35,474</u>
	Normalized Revenues	<26,080>
	Increase Needed	<u>\$ 9,394</u>
¹³	Revenue Requirements	\$35,474
	Less:	
	Adjusted Expenses	30,257
	Income Taxes	960
	Net Cash Flow	<u>\$4,257</u>

SUMMARY

After consideration of the evidence of record and being sufficiently advised, the Commission is of the opinion and finds that:

1. The rate in Appendix A, attached hereto and incorporated herein, is the fair, just, and reasonable rate for A & B and will produce gross annual revenues of approximately \$35,474 based on adjusted test-year sales. This rate will allow A & B sufficient revenues to meet its operating expenses and provide for future equity growth.

2. The rate proposed by A & B would produce revenue in excess of that found reasonable herein and should be denied.

IT IS THEREFORE ORDERED that:

1. The rate in Appendix A is approved for service on and after July 1, 1989.

2. The rate proposed by A & B is denied.

3. Within 30 days of the date of this Order, A & B shall file with the Commission its revised tariff sheets setting out the rate approved herein.


4. Within 60 days of the date of this Order, A & B shall refund all rates collected since July 1, 1989 which are in excess of the rate approved herein plus interest at a rate of 9.11 percent, the average of 3-month commercial paper rates for June 1989. Refunds shall be made by bill credit or direct payment.


5. Within 90 days of the date of this Order, A & B shall file with the Commission a summary statement showing a reconciliation of customer billings and the amount refunded.

Done at Frankfort, Kentucky, this 7th day of September, 1989.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 10391 DATED 9/7/89

The following rate is prescribed for the customers in the area served by A & B Sanitation Company, Inc. 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 effective date of this Order.

Flat Rate \$14.00