

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF FOREST HILLS DEVELOPERS )  
SEWAGE TREATMENT PLANT FOR AN )  
ADJUSTMENT OF RATES PURSUANT TO THE ) CASE NO. 94-264  
ALTERNATIVE RATE ADJUSTMENT PROCEDURE FOR )  
SMALL UTILITIES )

O R D E R

On July 11, 1994, Forest Hills Developers, Inc. ("Forest Hills") applied pursuant to the Commission's Alternative Rate Adjustment Procedure for authority to increase its rates by \$159,862, or 162 percent. By this Order the Commission authorizes an adjustment of rates to produce additional annual revenues of \$2,247.

The Commission permitted the following parties to intervene: Garey D. Higdon, Glenn D. Higdon, Anthony Durrall, Daniel Reynolds, Phillip Thompson, George Hulse, Leigh Land, Ltd., James T. Sisk, and Shelby Thompson (collectively "Southwood Apartments"), the Attorney General, Brett D. Butler, E.J. Higgs, and Robert Yaden.

Pursuant to 807 KAR 5:076, Section 8, Forest Hills placed the proposed rates in effect subject to refund on December 24, 1994, after 20 days notice to the Commission. The Commission held public hearings on the proposed rates on January 5, 6, and 10, 1995. The parties waived their right to file written briefs. Upon Forest Hills' submission on February 22, 1995 of documents

requested during the public hearing, this case stood submitted for decision.

#### COMMENTARY

Forest Hills is a private corporation which provides sanitary sewer service to the Forest Hills Subdivision of Jefferson County, Kentucky. Incorporated under the laws of Kentucky in 1962, it has operated a sewage treatment system since 1965.<sup>1</sup> As of December 31, 1993, it served a total of 773 customers - approximately 746 residential customers, 17 apartment buildings, 8 commercial customers, and two public schools.<sup>2</sup>

#### TEST PERIOD

Pursuant to 807 KAR 5:076, Section 2, the Commission has used the 12-month period ending December 31, 1993 as the test period for determining the reasonableness of the proposed rates. In using this historic test period, the Commission has given full consideration to appropriate known and measurable changes.

#### REVENUES AND EXPENSES

Forest Hills reported test period operating revenue of \$96,663.<sup>3</sup> It proposes several adjustments to test-year operations to normalize historical operating conditions and to reflect pro forma changes.

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<sup>1</sup> Forest Hills' Application at 49.

<sup>2</sup> Id. at 56.

<sup>3</sup> Id. at 2.

## Operating Revenues

Forest Hills reported test year operating revenue of \$96,663. However, the billing records of Forest Hills and the Louisville Water Company indicate that actual test year revenues were \$97,899.<sup>4</sup> Moreover, as a result of the incorrect billings of several apartment and commercial customers, Forest Hills underbilled its customers by \$2,202.<sup>5</sup> The Commission also adjusted operating revenues to reflect the loss of two commercial customers and the actual 1994 usage of commercial customers.<sup>6</sup> Based on these adjustments, the Commission finds that Forest Hills' test year operating revenue should be \$98,629.<sup>7</sup>

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<sup>4</sup> Apartment Units	\$20,909
Commercial Customers	7,059
Public Authority Customers	1,896
Residential Customers	<u>68,035</u>
Total:	<u>\$97,899</u>

See Forest Hills' Response to the Commission's Order of October 4, 1994; Exhibit FH-8.

<sup>5</sup> See Appendix B. The Commission compared the amount which Forest Hills actually billed to the amount which Forest Hills' filed rate schedule required.

<sup>6</sup> During 1993 commercial customers produced approximately 3,432,960 gallons of wastewater. In 1994 they produced only 2,327,040 gallons of wastewater.

3,432,960 gals × \$15.96/12,000 gals	\$ 4,565
2,327,040 gals × \$15.96/12,000 gals	- 3,094
Total Revenue Reduction	<u>\$ 1,471</u>

<sup>7</sup> Operating Revenue (Corrected Billings)	\$100,100
Adjustment 1994 Actual Usage	<u>\$ 1,471</u>
Adjusted Operating Revenue	<u>\$ 98,629</u>

## Labor and Expenses

Forest Hills reported collection system/labor and expenses of \$57,778 for the test period. Of this amount, approximately \$57,367 is classified as collection system labor and represents services provided by Hardin Sanitation, Inc. ("Hardin Sanitation") to pump sludge from Forest Hills' polishing lagoon to drying beds.<sup>8</sup>

The same persons own and manage Forest Hills and Hardin Sanitation. As these entities are subject to common control and ownership, the utility bears a greater burden to demonstrate the reasonableness of this transaction. Merely showing that the expense is incurred is not enough. See Boise Water Corp. v. Idaho Pub. Util. Comm'n, 555 P.2d 163, 167 (Idaho 1976) ("Although the Company may have established actual incurrence of these operating expenses, that fact alone does not establish a prima facie case of reasonableness with respect to payments to affiliates.")

Forest Hills has failed to show that the level of these expenses are reasonable. Although the services in question are not unique and do not require any special training or expertise, Forest Hills did not solicit bids for them. It has provided no documentation on the quantity of sludge pumped or the number of hours required to provide these services.

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<sup>8</sup> Forest Hills' Response to the Commission's Order of October 4, 1994, Item 5(b).

Moreover, Forest Hills has failed to explain adequately why it required another entity to perform the work in question.<sup>9</sup> Hardin Sanitation was formed solely to serve the Forest Hills sewage treatment plant. Its total capitalization was \$1,000. Its employees and subcontractors were previously Forest Hills employees or contractors. Forest Hills owned most of the equipment which Hardin Sanitation used. None of the work performed required any special training or knowledge.

Had Forest Hills performed the work itself, significant cost savings would have been achieved. Hardin Sanitation's records indicate that Hardin Sanitation's cost of providing service represented only 30.1 percent of the total amount billed to Forest Hills.<sup>10</sup>

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<sup>9</sup> Forest Hills' president testified that a separate corporation was formed to limit the utility's exposure to lawsuits resulting from the repair work. This explanation is dubious. First, a far more effective means of protecting the utility is workers' compensation insurance. Both Hardin Sanitation and Forest Hills had such coverage. Second, Forest Hills could require any independent contractors to obtain such coverage. Third, there is no evidence to suggest that the cost of general liability insurance exceeded the cost of contracting the repair work out to Hardin Sanitation. Finally, given the close relationship between Forest Hills and Hardin Sanitation and its owners, it appears highly unlikely that the formation of a separate corporation would prevent a successful plaintiff from piercing the corporate veil and attaching Forest Hills' assets.

<sup>10</sup> Exhibit FH-1. For every dollar charged to Forest Hills, approximately 59 cents was profit. Of the remaining 41 cents, approximately 30.1 cents represents the actual cost of providing service and 10.9 cents represents general and administrative costs which Hardin Sanitation would not have incurred had Forest Hills performed the repair work itself.

The Commission finds that Forest Hills' use of Hardin Sanitation's services was unreasonable and resulted in an unreasonable level of labor expense. The reasonable level of expenses for Hardin Sanitation's services is that company's actual costs of \$17,267.<sup>11</sup> The Commission further finds that, as these services were to correct a condition which developed over a period of eight years, they are not recurring expenses and should be amortized over eight years. Accordingly, collection systems - labor expense has been reduced to \$2,569.<sup>12</sup>

Brett Butler and Southwood Apartments propose to eliminate the test period sludge hauling expense of \$5,042. They contend that expenses associated with sludge hauling are fully reflected in the collection systems - labor expense. The record does not support this contention. Forest Hills' president testified that this expense represented sludge hauled from the treatment plant to a disposal site. The Commission, therefore, makes no adjustment to this expense.

#### Routine Maintenance

During the test period, Forest Hills incurred an expense of \$15,840 for routine maintenance services which Hardin Sanitation provided. Brett Butler and Southwood Apartments propose to reduce this expense by \$11,088 to eliminate related company profits. Since Forest Hills now retains the firm of Eubank, Hall &

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<sup>11</sup>  $\$57,367 \times 30.1\% = \$17,267$

<sup>12</sup>  $\$17,267 \div 8 \text{ years} = \$2,158$   
 $\$57,778 - \$57,367 + \$2,158 = \$2,569$

Associates, Inc. to perform such services at a monthly fee of \$800, their proposal is moot. The Commission finds, however, that the test period expense should be decreased by \$6,240 to reflect the current cost of routine maintenance.

Office Expenses

Forest Hills recorded office expense of \$1,148 during the test period. It proposes to reduce that amount by \$212 to eliminate the office expenses associated with its previous rate adjustment application.<sup>13</sup> The Commission finds the proposed adjustment reasonable and accepts it.

The Commission further finds that test period office expense of \$400 for the use of a mobile telephone should be disallowed. Forest Hills currently subscribes to a mobile telephone service for its president's use. A.B. Schlatter testified, however, that the mobile telephone is not needed to transact utility business.<sup>14</sup> Utility records indicate that the mobile telephone is seldom used.<sup>15</sup> No regulatory requirement to subscribe to such service exists nor does the nature of the utility's business require the instant access which the service provides.

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<sup>13</sup> Case No. 92-561, Application Of Forest Hills Developers, Inc. For An Adjustment Pursuant To The Alternative Rate Filing Procedure For Small Utilities.

<sup>14</sup> T.R., Vol. III at 91.

<sup>15</sup> T.R., Vol. I at 66.

Outside Services

Forest Hills reported test period outside services expense of \$21,449.<sup>16</sup> It proposes to decrease that amount by \$3,666 to eliminate rate case expense for Forest Hills' previous rate application. Forest Hills' records indicate that legal fees of \$4,316 and accounting fees of \$1,000 associated with that application were reported for the test period. The Commission finds that test period expenses should be reduced by a total of \$5,316 to eliminate prior rate case expense.

Forest Hills also incurred expenses of \$5,052 and \$976 for legal representation in a Commission proceeding and in several actions involving the Louisville-Jefferson County Health Department. As Forest Hills was not found in these proceedings to have violated any statute or regulation, it should be permitted recovery of these expenses. As these expenses are not recurring expenses, however, they should be amortized over a three year period.<sup>17</sup>

Forest Hills has also incurred \$2,676 in legal fees in an administrative proceeding before the Cabinet for Natural Resources and Environmental Protection ("NREPC") for alleged violations of administrative regulations. The charges have not yet been

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<sup>16</sup> Accounting	\$ 5,721
Engineering	106
Legal	15,521
Security Work	<u>100</u>
Total	<u>\$21,448</u>

<sup>17</sup> (\$5,052 + \$976) + 3 years = \$2,009



adjudicated. The Commission therefore finds that these fees should be eliminated from test period operating expenses and that Forest Hills should be permitted to establish a deferral account for expenses associated with this litigation. The Commission will consider recovery of these expenses in Forest Hills' next rate proceeding.

Legal fees associated with Case No. 93-182<sup>18</sup> of approximately \$2,501<sup>19</sup> were also included in Forest Hills' test period operating expenses. In that proceeding, the Commission found Forest Hills in violation of KRS 278.160. Forest Hills brought an unsuccessful action for review of the Commission's Order.<sup>20</sup> The Commission finds that recovery of these fees from utility ratepayers should not be permitted. Forest Hills' ratepayers received no benefit from the utility's misconduct. Expenses incurred as a result of that misconduct, therefore, should also not be recovered.<sup>21</sup>

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<sup>18</sup> Case No. 93-182, Forest Hills Developers, Inc.: Alleged Violations of KRS 278.160.

<sup>19</sup> Exhibit FHA-1.

<sup>20</sup> Forest Hills Developers, Inc. v. Pub. Serv. Comm'n, No. 94-CI-00701 (Franklin Cir. Ct. Jan. 19, 1995) (slip op.).

<sup>21</sup> See, e.g., Mountain States Tel. & Tel. Co. v. FCC, 939 F.2d 1035, 1043 (D.C. Cir. 1991) ("the FCC may disallow any expense incurred as a result of carrier conduct that cannot reasonably be expected to benefit ratepayers. The cost a carrier incurs in defending a lawsuit that ends in a determination that it violated the anti-trust law is, like the judgment itself, incurred as a result of the carrier's illegal activity; if the carrier fails to rebut the presumption that the underlying conduct was not in the interests of ratepayers, then allowing recovery of its litigation costs via calculation of the carrier's revenue requirement would force ratepayers to subsidize the carrier's illegal conduct.

After review of the record, the Commission finds that test period outside services expense should be decreased by \$14,512 to \$6,937.

#### Insurance

During the test year, Forest Hills incurred an expense of \$867 for workers' compensation insurance. As the work performed by Hardin Sanitation required workers' compensation insurance coverage and as the Commission has previously found that Forest Hills should have performed this work, the Commission finds that Forest Hills' rates should reflect the cost of Hardin Sanitation's coverage. The level of this expense is increased \$433.<sup>22</sup>

#### Miscellaneous and General

Forest Hills included in operating expenses its dues for membership in the Home Builders Association of Louisville. Forest Hills' president testified that the sole purpose for this membership is to monitor the Louisville-Jefferson County Metropolitan Sewer District's acquisition efforts. The Home Builders Association monitors the Metropolitan Sewer District's efforts and has opposed its attempts to acquire privately owned sewage treatment plants without compensation.<sup>23</sup> As utility ratepayers derive no benefits from such membership, the Commission finds that this expense should be disallowed.

Forest Hills also reported an expense of \$1,583 for business meeting meals which were charged to Mr. Schlatter's American

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<sup>22</sup> \$1300 - \$867 = \$433. See Exhibit FH-17.

<sup>23</sup> T.R., Vol. III at 81 - 83.

Express Card. A review of the American Express Card invoices<sup>24</sup> indicates that other items, including Mr. Schlatter's annual card membership fee, the purchase of nine videotapes, and lodging at a Louisville motel, have been charged to this account. As to the charges associated with meals, Forest Hills failed to maintain any records to identify the purpose and circumstances of any meal. Given the meal prices and restaurants involved, the reasonableness of this expense and its benefit to utility ratepayers are questionable. In the absence of any records to support the claim of a business purpose, the Commission finds that this expense should be disallowed.

#### Rent

Forest Hills incurred rental expense of \$7,200 during the test period for its office. Its president owns the building in which the office is located and manages his other business operations from the same building. The monthly rental fee of \$600 includes office space, mailing service, telephone service, secretarial service, utilities, and office equipment.<sup>25</sup> Brett Butler and Southwood Apartments propose that this amount be disallowed since no allocation plan is available to evaluate Forest Hills' rental costs.

Given the office size and the range of services, the Commission finds that the rental expense is reasonable and should be allowed. The Commission, however, advises Forest Hills to

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<sup>24</sup> Exhibit FH-11.

<sup>25</sup> T.R., Vol. III at 21.

develop an allocation plan for future proceedings. This plan should include the total cost of operating the office with an allocation to all businesses operating from that office.

#### Owner/Manager Fee

Forest Hills included \$10,000 in its test year operating expenses for an owner/manager fee. The Commission has historically permitted owner/manager fees but limited them to \$2,400. The Commission finds that, given the nature of Mr. Schlatter's duties as owner and manager of Forest Hills, a \$2,400 owner/manager fee is appropriate. The \$10,000 test year owner/manager fee has therefore been reduced by \$7,600.

#### Amortization

Forest Hills has included \$28,779 in test period operating expenses to reflect the three year amortization of the \$86,337 cost of repairs which Hardin Sanitation performed. In 1984, the utility built two polishing lagoons to treat plant effluent. As early as 1989, significant sludge accumulation in these lagoons was apparent. Prior to 1991, however, the utility made no attempt to remove the sludge. In December 1991 it contracted with Hardin Sanitation for sludge removal. During the next two years, Hardin Sanitation billed the utility \$86,337 to construct drying lagoons, pump sludge from the polishing lagoons to the drying lagoons, and remove dried sludge from the plant site.

Forest Hills originally proposed to amortize these costs over three years. In support of its proposal, it contended that the need for removal recurs every three years. At the hearing,

however, Forest Hills' president testified that sludge removal was required every year and would cost an estimated \$191,500.

Forest Hills has not demonstrated the reasonableness of these expenses. It made no meaningful effort to solicit bids on the sludge removal projects.<sup>26</sup> Despite possessing the equipment and skill to perform the work on its own, it contracted with a related company at a price which greatly exceeded cost. Accordingly, the Commission finds that the expenses related to the sludge removal project should be reduced to \$48,061<sup>27</sup> to reflect the project's actual cost.

Forest Hills has not presented any credible evidence to support its argument that the sludge removal from the polishing lagoons will occur on an annual basis. The record shows that the problem developed over several years. Forest Hills has taken two years to remove the existing accumulation. A more appropriate amortization period for these costs should be the period of time over which the sludge accumulation occurred. As the polishing lagoons were built in 1984 and Forest Hills' first sludge removal efforts began in December 1991, the Commission finds that the

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<sup>26</sup> On each contract, Forest Hills solicited a bid from one bidder. In each case, this bidder had previously performed work for Forest Hills' president. Forest Hills did not publish any request for bids nor did it make any attempt to solicit bids from contractors within Jefferson County. There is no evidence to suggest that the one bid received reflected market conditions in Jefferson County.

<sup>27</sup> The actual cost of all services which Hardin Sanitation provided is \$65,328. See Exhibit FH-1. If the cost of the labor associated with sludge removal (\$17,267) is deducted, then the actual cost of Hardin Sanitation's remaining services is \$48,061.

lagoon repair should be amortized over eight years and amortization expense should therefore be reduced by \$22,771.<sup>28</sup>

#### Rate Case Expense Amortization

Forest Hills proposes to increase annual operating revenues by \$1,900 to reflect the three year amortization of the expenses associated with its current application for rate adjustment.<sup>29</sup> The Commission finds that the proposed adjustment is reasonable and has adjusted operating expenses to reflect this expense.

#### Depreciation

Forest Hills reports a depreciation expense of \$10,804 for the test period. After its review of the evidence, the Commission has reduced this expense by \$8,071.

Forest Hills reported for the test period depreciation on a mobile office. This office has never been placed into service.<sup>30</sup> Depreciation on this item should not be recovered until it is placed into service. The Commission therefore has decreased operating expenses by \$73 to eliminate test year depreciation taken on this equipment.

The Commission has also decreased depreciation expense by \$7,695 to eliminate depreciation on contributed property. The Commission has previously explained why recovery of depreciation on contributed property is not appropriate:

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<sup>28</sup>     \$48,061 + 8 years = \$6,008.  
       \$28,779 - \$22,771 = \$6,008.

<sup>29</sup>     Application at 3.

<sup>30</sup>     T.R., Vol. III at 99.

The value of contributed property in currently operating water and sewage utilities . . . is frequently more than the value of investor financed property. Further, it is common practice for a builder or developer to construct water and sewage facilities that add to the value and salability of his subdivision lots and to expense this investment cost in the sale price of these lots or, as an alternative, to donate these facilities to a utility company.

It is also recognized that many residential and commercial developments in metropolitan areas are served by privately-owned sewage systems. Further, that federal guidelines will require the incorporation of these sewage systems into a regional comprehensive sewer district at such time as connecting trunk lines are made available. Further, that to permit the accumulation of a depreciation reserve on contributed property that is to be abandoned would not, in our opinion, be in the public interest.

A-1 Builders, Inc., Case No. 7373 (Sept. 4, 1979) at 3. See also Princess Anne Utilities Corp. v. Virginia, 179 S.E.2d 714 (Va. 1971).

To determine the amount of test year depreciation expense related to contributed property, the Commission first determined that 71.71 percent of the Forest Hills' plant is contributed<sup>31</sup> and then applied that factor to the adjusted depreciation expense of \$10,731<sup>32</sup> to arrive at the decreasing adjustment of \$7,695.

<sup>31</sup>	Contribution in Aid of Construction	\$383,638
	Divided by: Utility Plant in Service	<u>534,969</u>
	Percent of Plant Contributed	<u>71.71</u>
<sup>32</sup>	Test year depreciation expense	\$10,804
	Less: Depreciation on mobile office	<u>73</u>
	Adjusted Depreciation	<u>\$10,731</u>

Other Taxes

Forest Hills reported taxes other than income of \$2,917. Its records<sup>33</sup> indicate that approximately \$936 of this amount was for property taxes for investment property which Forest Hills owns<sup>34</sup> and for a \$10 late payment penalty. The Commission finds that these expenses should be disallowed and only \$1,971 should be included in operating expense.

Interest to Associated Companies

During the test year, Forest Hills accrued \$25,737 in interest payable to Hardin Sanitation on an open account for services. Interest accrued at a rate of one and one-half percent per month. The Commission finds that this expense should be disallowed. As previously noted, the utility's decision to contract for services from Hardin Sanitation was not reasonable. Moreover, the utility acted unreasonably by incurring such a large amount of debt on an open account without considering other methods of financing.

Summary

Based on the findings regarding Forest Hills' test year operations, Forest Hills' operating statement appears as set forth in Appendix C to this Order.

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<sup>33</sup> Exhibit FH-7.

<sup>34</sup> 7329 St. Andrews Church Road \$168.55  
2105 Quillman Drive 767.00  
Total Taxes for Non-utility Property \$935.55



REVENUE REQUIREMENTS DETERMINATION

The Commission has historically used an operating ratio approach<sup>35</sup> to determine revenue requirements for small, privately-owned utilities.<sup>36</sup> This approach is used because no basis for rate-of-return determination exists or the cost of the utility has fully or largely been recovered through the receipt of contributions. The Commission finds that this method should be used to determine Forest Hills' revenue requirements.

Forest Hills requested an operating ratio of 88 percent. The Commission finds that this operating ratio would allow Forest Hills sufficient revenues to cover its reasonable operating expenses and to provide for reasonable equity growth. The adjusted operations provide Forest Hills with an operating ratio of 90 percent.<sup>37</sup>

An operating ratio of 88 percent results in a revenue requirement of \$100,876.<sup>38</sup> The Commission accordingly finds that

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<sup>35</sup> Operating Ratio is defined as the ratio of expenses, including depreciation and taxes, to gross revenues.

$$\text{Operating Ratio} = \frac{\text{Operating Expenses} + \text{Depreciation} + \text{Taxes}}{\text{Gross Revenues}}$$

<sup>36</sup> See, e.g., Case No. 7553, McKnight Utilities Co. (Ky. P.S.C. Nov. 13, 1979).

<sup>37</sup> \$88,771 + \$98,629 = .90.

<sup>38</sup>

Adjusted Operating Expenses	\$ 88,771
Operating Expenses	+ <u>.88</u>
Required Operating Revenue	\$100,876

Forest Hills should be permitted to increase its annual operating revenues by \$2,247.<sup>39</sup>

#### RATE DESIGN

Forest Hills has the following customer classes: 1) residential, 2) apartment, 3) laundry room hook-up, 4) commercial, and 5) public authorities. It charges a separate rate to each class. It proposes to increase each customer class by an equal percentage.

Sewer rates are generally based on the amount of plant capacity allocated to each customer classification. This allocation determines whether the sewer plant is operating at full capacity. Since a treatment plant which is operating at full capacity cannot add new customers, the allocation of plant capacity ultimately affects operating revenues and rates.

In allocating plant capacity, the Commission follows generally accepted wastewater usage criteria. Residential customers are allocated 400 gallons per day or 12,000 gallons per month. Apartment units are usually allocated 300 gallons per day or 9,000 gallons per month. The rates of commercial customers and other large users are based on a residential equivalent.<sup>40</sup> For example,

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<sup>39</sup> Required Operating Revenue	\$100,876
Minus: Adjusted Operating Revenue	<u>\$ 98,629</u>
Required Revenue Increase	<u>\$ 2,247</u>

<sup>40</sup> Until recently, Forest Hills has not properly applied this billing methodology. Instead of billing a commercial customer which produces 26,000 gallons of wastewater at a rate of 2.17 times the residential rate, it billed the customer at 3.0 times the residential rate. This "rounding up" required commercial customers to pay for a rate in excess of the lawful rate. In its revised tariffs, filed on February 14, 1995,

a commercial customer who used 26,000 gallons would be billed at a rate of 2.17 times the residential rate.

In establishing new rates for Forest Hills, the Commission has used this methodology. Residential and apartment buildings will be charged a fixed rate. The rate for apartment buildings will be 75 percent of the residential rate. Since usage should not differ regardless of the location of a washer, the laundry room hook-up rate has been eliminated.

Forest Hills serves two public schools under a special contract. Under this contract, Forest Hills charges a declining block rate with a rate of \$0.425 per 1,000 gallons for all wastewater in excess of 2,000 gallons. This rate is substantially below that charged to other customers and amounts to a subsidy to the public schools. After reviewing the contract, the Commission finds that the rates to these schools should also be based on the 12,000 gallon residential equivalent.<sup>41</sup>

#### FREE SERVICE TO UTILITY OFFICIALS

During the hearing in this matter, Forest Hills' president testified that the utility is currently providing free service to past and present officials.<sup>42</sup> KRS 278.160 prohibits a utility from charging or collecting from any person a greater or less

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Forest Hills has conformed its billing practices to this methodology.

<sup>41</sup> Southwood Apartments and Brett Butler argue that the current rate violates KRS 278.035. Notwithstanding the merits of their argument, our decision renders the question moot.

<sup>42</sup> T.R., Vol. III at 70 - 73.

compensation for any service than that prescribed in filed rate schedules. It further prohibits any person from receiving any service from a utility for a compensation greater or less than that prescribed in the utility's filed rate schedules. While a utility may provide free or reduced rate service to its officers, agents or employees, it may do so only after notice of the reduced rate is given to the Commission and the Commission agrees. KRS 278.170. Forest Hills has never received such approval.

The Commission finds that prima facie evidence exists that Forest Hills has violated KRS 278.160. By separate order, the Commission is initiating a new proceeding to investigate these alleged violations. The Commission further finds that Forest Hills should immediately cease its practice of providing free utility service to its officials without prior Commission approval.

#### ADJUSTMENT OF COMMERCIAL BILLINGS

Forest Hills' filed rate schedule requires that the utility annually adjust the number of residential equivalents charged to a commercial customer to reflect the customer's current usage patterns.<sup>43</sup> During the course of this proceeding, it became readily apparent that the utility had failed to perform such adjustments. The Commission finds that KRS 278.160 requires Forest Hills to review at least annually the water usage of those customers whose bills are based on residential equivalents and make any necessary adjustments. Failure to perform such review and to make appropriate adjustments will be deemed a violation of KRS 278.160.

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<sup>43</sup> Forest Hills Original Tariff Sheet No. 2.

## SUMMARY

After review of the evidence of record and being otherwise sufficiently advised, the Commission finds that:

1. Forest Hills' adjusted test year revenues are \$98,629.
2. Forest Hills' adjusted test year operating expenses are \$88,771.

3. An operating ratio of 88 percent will provide Forest Hills with sufficient revenues to cover its reasonable operating expenses and to provide for reasonable equity growth.

4. Based on an operating ratio of 88 percent and Forest Hills' adjusted test period revenues and expenses, Forest Hills should be permitted to earn revenues of \$100,876.

5. The rates in Appendix A are the fair, just and reasonable rates for Forest Hills and will produce annual revenues of \$100,876 based on adjusted test-year revenues.

6. The rates proposed by Forest Hills will produce revenue in excess of that found reasonable and should be denied.

IT IS THEREFORE ORDERED that:

1. The rates proposed by Forest Hills are hereby denied.
2. The rates set forth in Appendix A are approved for service rendered by Forest Hills on and after December 24, 1994.
3. Within 20 days of the date of this Order, Forest Hills shall file with the Commission revised tariff sheets setting forth the rates approved herein.

4. Forest Hills shall refund the revenues collected in excess of the rates determined appropriate herein plus interest at a rate of six percent.

5. The refund shall be made by either direct payment or bill credit and shall be made within 60 days of the date of this Order.

6. Within 30 days of the date the refund is completed, Forest Hills shall file with the Commission a summary statement showing a reconciliation of customer billings and the amount refunded.

7. Within 60 days of the date of this Order, Forest Hills shall adjust the bills of the customers<sup>44</sup> listed in Appendix B to correct for incorrect billings. For customers overbilled, Forest Hills shall by direct payment or bill credit refund the amount overbilled. For customers which were underbilled, Forest Hills shall issue a charge for the underbilled amount on its next billing.

8. Within 30 days of the date of completion of the billing adjustment, Forest Hills shall file with the Commission a summary statement showing a reconciliation of customer billings and the amount refunded or charged.


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<sup>44</sup> "Customer" includes both current and former customers.

9. Forest Hills shall immediately cease providing free or reduced service to present and former utility officials.

Done at Frankfort, Kentucky, this 4th day of May, 1995.

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. 94-264 DATED MAY 4, 1995.

The following rates and charges are prescribed for the customers in the area served by Forest Hills Developers, 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.

RATES: Monthly

Residential	\$8.07
Apartments - Per Unit	6.05
Commercial and Schools	8.07 per R.E. <sup>1</sup>

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<sup>1</sup> A residential equivalent is defined as 12,000 gallons or fraction thereof. A fraction shall not be rounded to the next whole number.



APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION  
IN CASE NO. 94-264 DATED MAY 4, 1995.

Apartments	Units	Hook Ups	Bi-monthly TY Actual	Bi-monthly Corrected	1993 due Forest Hills	1993 due Customer
Richard S. Thompson	46	6	\$562.98	\$615.60	\$315.72	
Brett Butler	16	0	166.40	182.40	96.00	
Cardinal Hills Gardens						
7331 St. Andrews	26	0	148.37	296.40	888.18	
7337 St. Andrews	24	0	136.96	273.60	819.84	
7339 St. Andrews	11	20	277.55	429.40	911.10	
7343 St. Andrews	12	0	136.96	136.80		0.96
7345 St. Andrews	12	0	136.96	136.80		0.96
7347 St. Andrews	24	0	136.96	273.60	819.84	
7349 St. Andrews	24	0	136.96	273.60	819.84	
Pennacook Apartments						
2520 Pennacook	16	0	166.40	182.40	96.00	
2528 Pennacook	8	0	83.20	91.20	48.00	
2534 Pennacook	8	0	83.20	91.20	48.00	
2538 Pennacook	8	0	83.20	91.20	48.00	
Southwest Apartments						
2501 Pennacook	24	0	273.91	273.60		1.86
2509 Pennacook	12	0	136.96	136.80		0.96
2517 Pennacook	12	0	155.95	136.80		114.90
2601 Pennacook	50	5	<u>661.87</u>	<u>646.00</u>	<u>00.00</u>	<u>95.22</u>
<b>Total</b>			<u>\$3,484.79</u>	<u>\$4,267.40</u>	<u>\$4,910.52</u>	<u>\$214.86</u>

Commercial	Usage	1993 R.E. Per Month	Bi-monthly TY Actual	Bi-monthly Corrected	1993 due Forest Hills	1993 due Customer
Bob Kat, Inc.	183,000	1.27	63.85	40.57		\$139.71
Convenient Laundry	1,185,000	9.88	574.43	315.21		1,665.32
JDJF Eichberger	269,000	1.87	63.85	59.63		25.33
Mt. Calvary Church	61,000	1.00	67.04	31.92		210.72
Mt. Calvary Church	106,000	1.00	63.85	31.92		191.58
Pizza King/Bambinos	189,000	1.31	63.85	41.82		132.21
Quick as a Wink	506,000	3.51	<u>152.00</u>	<u>112.16</u>		<u>39.02</u>
<b>Total:</b>			<u>\$1,048.87</u>	<u>\$633.23</u>	<u>\$0.00</u>	<u>\$2,493.89</u>

**Total Due Forest Hills:**  
**Total Due Customers:**

**\$4,910.52**

**\$2,708.75**

## APPENDIX C

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION  
IN CASE NO. 94-264 DATED MAY 4, 1995.

	Test Year	Adjustment	Adjusted Test Year
OPERATING REVENUES	<u>\$ 96,663</u>	\$ 1,986	<u>\$ 98,629</u>
OPERATING EXPENSES			
Operation			
Labor and Expenses			
Collection System	57,778	(55,209)	2,569
Pumping System	946		946
Sludge Hauling	5,042		5,042
Utility Service - Water	218		218
Other Labor	2,721		2,721
Fuel and Power	16,175		16,175
Chemicals	1,116		1,116
Misc. Supplies			
Collection System	85		85
Pumping	69		69
Maintenance			
Engineering-Service Fees	15,840	(6,240)	9,600
Pumping	524		524
Treatment/Disposal	9,915		9,915
Other Plant Facilities	539		539
Customer Service			
Agency Collection Fee	4,230		4,230
Administrative and General			
Office Supplies	1,148	(612)	536
Outside Services Employed	21,449	(14,512)	6,937
Insurance	867	433	1,300
Transportation	3,249		3,249
Miscellaneous	2,283	(1,808)	475
Rent	7,200		7,200
Owner/Manager Fee	<u>10,000</u>	<u>(7,600)</u>	<u>2,400</u>
Total Operation and Maintenance Expenses	\$ 161,394	\$(85,548)	\$ 75,846
Amortization Expense	28,779	(20,871)	7,908
Depreciation	10,804	(7,768)	3,036
Taxes Other Than Income	<u>2,917</u>	<u>(936)</u>	<u>1,981</u>
TOTAL OPERATING EXPENSES	<u>\$ 203,894</u>	<u>\$ (115,123)</u>	<u>\$ 88,771</u>
NET OPERATING INCOME	<u>(107,231)</u>	<u>\$ 117,089</u>	<u>9,858</u>
INTEREST EXPENSE	<u>25,737</u>	<u>(25,737)</u>	<u>0</u>
NET INCOME	<u>\$ (132,968)</u>	<u>\$ 142,826</u>	<u>\$ 9,858</u>