

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF HAYFIELD UTILITIES,)
INC. FOR A RATE ADJUSTMENT PURSUANT) CASE NO.
TO THE ALTERNATIVE RATE FILING) 97-457
PROCEDURE FOR SMALL UTILITIES)

ORDER

Hayfield Utilities, Inc. ("Hayfield") has applied for Commission approval of a proposed increase in its rates for sewer service. Hayfield proposes rates that would generate additional annual revenues of \$51,481, an increase of 121 percent. By this Order, the Commission denies the proposed rate adjustment and establishes new rates that will generate gross annual revenues of \$57,112, an increase of 34 percent over existing rates.

Procedure

On December 10, 1997, Hayfield filed its application pursuant to Administrative Regulation 807 KAR 5:076 for a rate adjustment. The Countryside Homeowners' Association ("Homeowners' Association") intervened in this matter. After conducting a limited review of Hayfield's financial records, Commission Staff on June 24, 1998, issued a report in which it recommended a \$13,839 increase in the utility's annual operating revenues for sewer service. Hayfield subsequently requested an informal conference to discuss the Commission Staff Report.

Following the conference, which was held on July 28, 1998, Hayfield submitted specific objections to Commission Staff's findings and recommendations. On August

13, 1998, Commission Staff responded to these objections. The Homeowners' Association voiced no objections to Commission Staff's findings and recommendations. Pursuant to the Commission's Order of August 20, 1998, this case stood submitted for decision on August 30, 1998, when no party requested a hearing in this matter.

Discussion

As the parties to this case have accepted most of Commission Staff's findings and recommendations, the Commission addresses in this Order only those issues in dispute.

Owner-Manager Fee

During the test period,¹ Hayfield paid its owner a management fee of \$4,800. Commission Staff recommended that \$1,200 be disallowed and that a reasonable management fee be limited to \$3,600. Commission Staff reasoned that, given Hayfield's relatively small size,² it required minimal attention from its owner. Moreover, contractors perform Hayfield's primary operations – routine and non-routine maintenance, billing and collection, bookkeeping, and sludge hauling.

Hayfield contends that the recommended fee of \$3,600 is inadequate. Such fee, it contends, fails to adequately compensate its owner for the duties and liabilities inherent in the operation of a sewage treatment plant. It further contends that the recommended fee, moreover, fails to reflect the skills and experience that its owner brings to the utility.

¹ The test period for determining Hayfield's revenue requirements was Calendar Year 1996.

² Hayfield had only 144 customers during the test period.

The Commission finds little merit in Hayfield's argument. The primary purpose of the management fee is to compensate the management for duties performed for the utility. In the case at bar, the owner's duties are limited and his involvement in day-to-day operations is not significant. As contractors perform the bulk of the utility's operations, we find a management fee of \$4,800 to be unreasonable. The Commission notes, moreover, that in addition to any management fee, the owner of the utility is compensated through utility earnings. Accordingly, we find that the reasonable level of any management fee in this proceeding should be \$3,600.

Routine Maintenance Fee

In its application, Hayfield proposed to increase its test year routine maintenance expense of \$7,500 by \$1,200 to reflect a proposed contract change with Jefferson Environmental Services, Inc. ("Jefferson Environmental"). During the test period, Jefferson Environmental provided routine maintenance services at a monthly fee of \$650. Under the proposed contract, Jefferson Environmental, in addition to performing its present maintenance services, would perform a second daily inspection of the Hayfield sewage treatment plant and would also perform a weekly "supervisor" inspection. Hayfield contends that these additional inspections are required to ensure the proper performance of its sewage treatment plant and to ensure that inspectors whom Jefferson Environmental retains are properly maintaining the sewage treatment plant.

Commission Staff recommended the proposed adjustment be rejected and that the monthly expense be limited to \$625. It noted that transactions between Jefferson

Environmental and Hayfield were related party transactions. Hayfield's owner, Carroll Cogan, is the father of one of Jefferson Environmental's principal owners.³ It further noted that Jefferson Environmental provides maintenance services to four of Mr. Cogan's sewer utilities and that these sewer utilities are of comparable size.⁴ In each instance, Jefferson Environmental charges a different maintenance fee. Commission Staff recommended that, in the absence of any explanation for the differing fees, the lowest monthly fee of \$625 should be used.

After reviewing the record, the Commission finds no reasonable explanation for the increased inspections. Hayfield has not pointed to any regulatory or statutory requirement for increased inspections nor has it pointed to any significant benefit to accrue from these inspections. Moreover, the Commission finds no reason for ratepayers to incur additional costs to ensure that Jefferson Environmental's contract inspectors are properly performing their duties. We concur with Commission Staff's recommendation and include only a monthly routine maintenance fee of \$625 in Hayfield's revenue requirements.

Outside Services Employed – Other Consulting Fees

During the test period, Hayfield paid a monthly fee of \$75 to Martin and Associates to serve as a liaison between the utility and state environmental regulators and to file monthly discharge monitoring reports. Martin and Associates' primary

³ Martin Cogan is the son of Carroll Cogan and is a principal shareholder of Jefferson Environmental. Mr. Cogan is also vice-president of Hayfield Utilities.

⁴ These utilities are Hayfield Utilities, Orchard Grass Utilities (Willow Creek Sewer System), Orchard Grass Utilities (Orchard Grass Hills), and Farmdale Development Corporation.

service was to enter information from its discharge monitoring reports on to an electronic spreadsheet. Beckmar Laboratory prepares the utility's discharge monitoring reports. Martin Cogan, Carroll Cogan's son and Vice President of Hayfield, is the principal shareholder and owner of Martin and Associates.

The Commission finds that these fees involve transactions between related parties and that Hayfield must demonstrate that these fees were reasonable and prudent business expenses. It has failed to do so. The owner-manager's primary responsibility is to deal with state environmental regulators. The owner-management fee serves as reasonable compensation for such duties. Hayfield has failed to demonstrate that its owner-manager could not provide these services or that the fees were reasonable for the services provided. Accordingly, the Commission finds that such fees should not be included in the calculation of Hayfield's revenue requirements.

Conclusion

Having considered the evidence of record and being otherwise sufficiently advised, the Commission finds that:

1. The findings and recommendations contained in the Commission Staff Report are supported by substantial evidence, are reasonable, and should be adopted as the findings of the Commission.
2. The rates in the Appendix to this Order are the fair, just, and reasonable rates for Hayfield and will produce gross annual revenues of \$57,113 for sewer service.

These rates will allow Hayfield sufficient revenues to meet its operating expenses, and provide for future equity growth.

3. The rates proposed by Hayfield will produce revenue in excess of that found reasonable herein and should be denied.

IT IS THEREFORE ORDERED that:

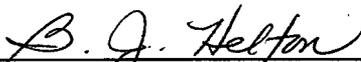
1. The findings contained in the Commission Staff Report are adopted and incorporated by reference into this Order as if fully set out herein.

2. The rates proposed by Hayfield in its application are denied.

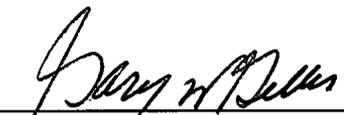
3. Within 30 days of the date of this Order, Hayfield shall file with the Commission revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 9th day of October, 1998.

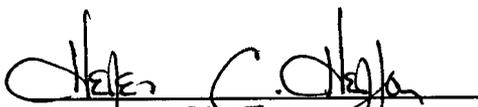
PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:


Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 97-457 DATED OCTOBER 9, 1998

The following rates and charges are prescribed for the customers in the area served by Hayfield Utilities, Inc. All other rates and charges not specifically stated herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this order.

Single Family Residential

32.60 per Month