COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ALTERNATIVE RATE FILING APPLICATION OF MIDDLETOWN WASTE DISPOSAL, INC.	))	CASE NO. 2009-00227

ORDER

Middletown Waste Disposal, Inc. ("Middletown") has applied, pursuant to 807 KAR 5:076, for an adjustment of rates to increase its annual operating revenues by $56,459, or 41.8 percent, over reported test-period revenues. By this Order, we establish rates that will produce annual operating revenues of $159,965, an increase of $22,815, or 16.63 percent, over normalized revenues from rates of $137,150.

BACKGROUND

Middletown, a corporation organized pursuant to KRS Chapter 271A, owns and operates sewage collection and treatment facilities in Jefferson County, Kentucky that are not subject to regulation by a metropolitan sewer district and that serve approximately 195 customers.[1] Prior to this proceeding, Middletown had not been a subject of a Commission proceeding since 1981 when we granted a Certificate of Public Convenience and Necessity to construct its sewage collection and treatment facilities and authorized initial rates for sewer service.[2]

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[1] *Annual Report of Middletown Waste Disposal, Inc. to the Public Service Commission of Kentucky for the Calendar Year Ended December 31, 2008* at 12.

[2] Case No. 7732, *Middletown Waste Disposal, Inc.* (Ky. PSC Jan. 23, 1981).

On June 19, 2009, Middletown tendered its application to the Commission for authority to adjust its sewer rates pursuant to 807 KAR 5:076.[3] Because of deficiencies in its application, the Commission did not accept the application for filing until July 2, 2009. The proposed rates, which Middletown proposed to become effective on August 10, 2009, would produce annual operating revenues of $191,463, an increase of $56,459 or 42 percent, over reported test-period operating revenues from existing rates of $135,004.

After establishing this docket, the Commission, on July 30, 2009, suspended the operation of the proposed rates for five months until January 10, 2010. On November 2, 2009, the Commission permitted the Attorney General ("AG") to intervene as a party in this matter. At the request of Middletown, an informal conference between the parties and Commission Staff was held on February 17, 2010.

During the case proceeding, Commission Staff conducted discovery on the applicant in preparation of a report on the proposed rate adjustment. On April 1, 2010, the Commission Staff's report on the proposed adjustment was entered into the record and the Commission ordered all parties to submit any written comments or requests for informal conference within seven days. We further advised the parties that the failure to make a timely objection to a Commission Staff finding or recommendation would be considered as agreement with the finding or recommendation.

In its report, Commission Staff found that, based upon Middletown's recommended pro forma operations and an operating ratio of 88 percent, Middletown's

[3] 807 KAR 5:076 "provides a simplified and less expensive procedure by which small utilities may apply to the [C]ommission for rate increases."

revenue requirement from rates was $152,458, an increase of $15,308 or 11.16 percent over Staff's normalized revenue from rates of $137,150.

On April 7, 2010, Middletown filed objections to Commission Staff's findings and recommendations and moved for a formal hearing in this proceeding. It specifically objected to Commission Staff's findings regarding a proposed owner/manager fee expense, the requested use of a three-year amortization period for certain expenses, and requested insurance, transportation, office rent and interest expenses. By separate letter, Middletown requested an informal conference.

On the same day, the AG filed his comments on the report. In these comments, the AG, while generally accepting Commission Staff's recommendations, recommended adjustments to reduce test-period rent expense,[4] pro forma depreciation expense,[5] and amortization expense.[6] If accepted, the AG's adjustments would produce a revenue requirement of $147,716, an increase of $10,566 above normalized operating revenues of $137,150, or approximately $4,742 lower than Commission Staff's recommended level.[7]

On April 14, 2010, a second informal conference was held in this matter, also at the request of Middletown. At the time of the conference, Middletown filed with the Commission additional documents and information regarding future plant replacements;

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[4] AG's Written Comments to Commission Staff Report at 6 (filed Apr. 7, 2010).

[5] *Id.* at 7-8.

[6] *Id.* at 9-10.

[7] *Id.* at 11.

the calculation of insurance premiums; and rate case expenses.[8] Middletown then filed a "Settlement Agreement, Stipulation, and Recommendation" on April 19, 2010 in which Middletown and the AG agreed and recommended that the Commission authorize rates that would permit Middletown to recover an additional $52,939 in annual revenues. Middletown also filed written testimony in support of the agreement and a motion for Commission approval of the agreement.

The Commission conducted a hearing in this matter on April 21, 2010.[9] At this hearing, Commission Staff presented testimony regarding the proposed rate adjustment.[10] It revised its original adjustments regarding: (1) depreciation of post-test period capital expenditures;[11] (2) the amortization expense;[12] and (3) the revenue

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[8] Letter from Richard A. Greenberg, counsel for Middletown Waste Disposal, to Jeff Derouen, Executive Director, Public Service Commission (Apr. 14, 2010).

[9] The only person testifying at this hearing was Commission Staff member Mark C. Frost. Commission Staff did not call Commission Staff member Jason Green, who authored the portions of the Commission Staff report related to rate design, to testify. Jack Kaninberg, who filed written testimony on Middletown's behalf, also was not called as a witness.

[10] Video Transcript at 7:34 – 9:42.

[11] Commission Staff recommended increasing depreciation expense by $22,300 to reflect the depreciation over a five-year period of certain plant improvements totaling $111,500. (Total Plant Cost ÷ Service Life = $111,500 ÷ 5 years = $22,300 per year.) Commission Staff apparently based its revision on an itemized estimate of the cost of certain plant improvements from the firm of Sanders Sales and Service. *See* Letter from Greenberg to Derouen (Apr. 14, 2010) at Exhibit D.

[12] Commission Staff recommended that its original recommendation to increase amortization expense by $2,442 to reflect the amortization of legal fees be revised to $5,123 to reflect additional legal fees that Middletown incurred after the issuance of the Commission Staff report. Commission Staff also recommended that amortization expense be reduced by $72 to reflect an error in the Commission Staff report regarding the cost of Middletown's present KPDES permit. The AG had noted this error in his comments to the report.

requirement effect on insurance premiums.[13] Based upon these revised adjustments, Commission Staff recommend a revenue requirement of $186,438, an increase of $49,288 over normalized operating revenue of $137,150.[14]

Following the testimony regarding Commission Staff's revisions to its recommendations, Middletown and the AG submitted a Revised Settlement Agreement that incorporated Commission Staff's revised revenue requirement and requested rates for Middletown that would produce an increase in annual revenues of $49,288. Both expressly advised that their agreement was based upon Commission Staff's revised findings and recommendations.[15] All other provisions of the original Settlement Agreement remained unchanged.

COMMISSION FINDINGS

Based upon our review of the evidence of record, we find the findings and recommendations that are related to accounting adjustments and revenue requirements contained in the revised Commission Staff Report,[16] except as discussed below, are

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[13] In its report, Commission Staff recommended that insurance expense of $9,972 be decreased by $3,505 to eliminate insurance premiums for prior periods and the insurance for the Jeep that is not registered to Middletown. Commission Staff Report, App. C at 7-8. In its April 14, 2010 filing, Middletown provided the formula used to calculate the insurance premium. *See* Letter from Greenberg to Derouen (Apr. 14, 2010) at Exhibit D. Using this formula and the normalized operating revenues, Commission Staff calculated a pro forma insurance premium of $6,689, which is $223 greater than the premium included in its report.

[14] Video Transcript at 8:23 – 8:33.

[15] *Id.* at 11:03 – 12:00.

[16] The "revised Commission Staff Report," consists of the Commission Staff Report appended to the April 1, 2010 Order, as modified and amended by Commission Staff's testimony at the April 21, 2010 hearing.

reasonable. For reasons set forth below, we find that the record fails to support the proposed recovery of depreciation expense for post-test-period capital expenditures and that the inclusion of such expense in pro forma operating expenses for ratemaking purposes is unreasonable. Therefore, we find the revenue requirement recommended in the revised Commission Staff Report is unreasonable. As the parties' agreed revenue requirement is based upon Commission Staff's modified recommendations, including those related to the recovery of depreciation expense for post-test-period capital expenditures, we further find the revised "Settlement Agreement, Stipulation, and Recommendation" is also unreasonable and should be denied. Given this finding, the Commission believes that the Revised Settlement Agreement is likewise unreasonable and should be denied.

In its application, Middletown proposed to amortize over three years $66,099 of capital repairs incurred during the test period. It further estimated that "a long-term fix to the sewer plant may require expenditures totaling $100,000."[17] In response to a discovery request, Middletown listed approximately $111,000 in capital expenditures that "will be necessary to keep the plant operating and compliant" and noted that the timing of these expenditures was dependent upon the rate relief granted in this proceeding.[18] It estimated that, "if the requested revenue increase of $56,459 per year is granted," it could make the necessary expenditures within two to three years.[19]

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[17] Application, Attachment A at note M.

[18] Middletown's Response to the Commission Staff's Initial Information Request, Item 3.

[19] *Id.*

In its filing of April 14, 2010, Middletown provided an itemized estimate showing that the post-test-period capital expenditures would cost $111,500 and insisted that they "must be performed in order to appropriately maintain plant operations."[20] It insists that these expenditures can only be funded through additional revenue from rates.[21]

While Commission Staff found merit in these arguments, we find little evidence in the record to support the recovery through rates of depreciation expense on capital expenditures that have yet to be made. The record clearly shows that Middletown has not yet made any of the capital expenditures in question. Moreover, Middletown has not provided a definite and specific schedule for making the capital improvements or provided any assurances or compelling reasons that the capital improvements will be made.[22] Middletown, furthermore, has failed to demonstrate with any certainty the cost of the capital improvements needed to maintain the sewer facilities. It offers only a single estimate of the improvements' cost. It has not conducted any survey of the costs of the proposed improvements in the Jefferson County market or produced estimates from different vendors to demonstrate the reasonableness of its estimate. Finally, Middletown has provided no evidence of its alleged inability to obtain financing to undertake the proposed capital improvements.

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[20] *See* Letter from Greenberg to Derouen (Apr. 14, 2010) at 2 and Exhibit D.

[21] *Id.*

[22] In this respect, the present situation is readily distinguishable from circumstances where the sewer utility is required by an order of a court or administrative agency to make repairs or capital improvements. In those circumstances, the utility's failure to act will lead to administrative or judicial sanctions, to include civil penalties and imprisonment for contempt. Middletown is not presently under such order.

Based upon our acceptance of all Commission Staff's recommendations related to accounting adjustments and revenue requirements, except those regarding depreciation expense on post-test period capital expenditures, we find that Middletown's operating expenses should be $135,240. We further find that, using the operating ratio approach to determine Middletown's revenue requirement and applying an operating ratio of 88 percent to this level of expenses, Middletown's revenue requirement is $159,965 and that Middletown requires an increase in revenues of $22,815 over normalized revenues from sewer rates of $137,150.[23]

The rates in the Appendix to this Order are based upon an increase of 16.63 percent that has been applied to each of the rates that Middletown presently charges.[24] The rates in the Appendix will produce the revenue requirement of $159,965 determined reasonable herein.

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Pro Forma Operating Expenses	$	135,240
Divided by: Operating Ratio	÷	88%
Subtotal	$	153,682
Add: Interest Expense		4,769
Insurance Premium Increase	+	1,514
Revenue Requirement	$	159,965
Less: Operating Revenues	-	137,150
Increase in Revenues	$	22,815

24 In its report, Commission Staff noted that, since June 1997, Middletown has charged a Residential Rate of $15.00 per month but has never revised its filed rate schedules to reflect this rate. *See* Commission Staff Report at 4-7; Middletown's Response to the Commission Staff's First Information Request, Item 1(a). This issue of charging an untariffed rate will be examined in a subsequent Commission proceeding. In addition, Middletown's filed tariffs have included, for almost 20 years, a rate for service to the Kentucky Department of Transportation District #5 Office. Since no service has ever been provided under that rate, it has been eliminated from the rates approved herein.

The Commission recognizes that the evidentiary hearing held in this case on April 21, 2010 focused solely on the recommendations in the revised Commission Staff Report, which included additional revenues to fund future capital expenditures. Based upon our decision herein to exclude those additional revenues from rates, the parties may desire a further hearing on this issue. If so, an application for rehearing should be filed pursuant to KRS 278.400. In the event that such an application is filed, a hearing will be scheduled within 20 days of the granting of the application for rehearing.

SUMMARY OF FINDINGS

Based upon the evidence of record and being otherwise sufficiently advised, the Commission finds that:

1. The findings and recommendations relating to accounting adjustments and revenue requirements contained in the revised Commission Staff Report, as modified herein, are reasonable and should be adopted.

2. Based upon adjusted test-period operations, Middletown requires $159,965 in annual revenues to cover its reasonable operating expenses and to provide for reasonable equity growth.[25]

3. Middletown's proposed rates will produce revenue in excess of that found reasonable and should be denied.

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[25] These revenues provide for the recovery of interest expense on certain debt instruments whose issuance may not have been authorized by the Commission. *See* Commission Staff Report at 6-7. The Commission will examine this issue in a subsequent proceeding.

4. The rates set forth in the revised Commission Staff Report and the parties' revised "Settlement Agreement, Stipulation, and Recommendation" will produce revenue in excess of that found reasonable and should be denied.

5. The rates set forth in the Appendix to this Order will produce gross annual revenues of $159,965 and should be approved for service Middletown renders on and after the date of this Order.

IT IS THEREFORE ORDERED that:

1. Middletown's proposed rates are denied.

2. The findings and recommendations relating to accounting adjustments and revenue requirements contained in the revised Commission Staff Report, as modified herein, are adopted and incorporated by reference into this Order as if fully set out herein.

3. Middletown's Motion to Approve Settlement is denied.

4. The parties' Settlement Agreement, Stipulation, and Recommendation is not accepted.

5. Middletown shall charge the rates set forth in the Appendix to this Order for service rendered and after the date of this Order.

6. Any request for a further hearing on the issue of additional revenues to fund future capital expenditures should be set forth in an application for rehearing filed pursuant KRS 278.400.

7. Within 20 days of the date of this Order, Middletown shall file with the Commission revised tariff sheets setting out the rates approved in this Order.

By the Commission

ENTERED

APR 30 2010

KENTUCKY PUBLIC SERVICE COMMISSION

ATTEST:

Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2009-00227 DATED APR 3 0 2010

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

<u>Residential Rate</u>	
Flat Rate	\$ 17.50 per month
<u>Industrial Rate</u>	
First 20,000 Gallons	\$ 93.40 minimum bill
Over 20,000 Gallons	\$ 4.67 per 1,000 gallons
<u>English Station Shopping Center</u>	
First 7,500 Gallons	\$ 35.03 minimum bill
Over 7,500 Gallons	\$ 4.67 per 1,000 gallons

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