

COMMONWEALTH OF KENTUCKY
BEFORE THE UTILITY REGULATORY COMMISSION

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In the Matter of:

THE APPLICATION FOR A CERTIFICATE)
OF CONVENIENCE AND NECESSITY AND)
THE ESTABLISHMENT OF SANITARY SEWER) CASE NO. 7499
RATES FOR THE MEADOW CREEK FARM)
SUBDIVISION, OLDHAM COUNTY, KENTUCKY)

O R D E R

Preface

On June 26, 1979, Evercliff Corporation, hereinafter referred to as the "Applicant", filed with this Commission its petition seeking a certificate of Public Convenience and Necessity authorizing the construction of a waste water collection and treatment system for the Meadow Creek Farm Subdivision located in Oldham County, Kentucky; and the establishment of initial rates for providing domestic sewage disposal services.

The case was set for hearing at the Commission's offices in Frankfort, Kentucky, July 31, 1979. All parties of interest were notified, and no protests were entered. During the hearing, certain requests for additional information were made by the Commission Staff. This information has been filed and the entire matter is now considered to be fully submitted for a final determination by this Commission.

A copy of a preliminary approval issued by the Kentucky Department for Natural Resources and Environmental Protection in this matter is on file with this Commission.

Test Period

This is a proposed rather than an operating utility and there are no operating records to be utilized for rate-making purposes. Estimated proforma expenses were, therefore, utilized for determination of revenue requirements and the rate that could produce required revenues was based on 100% occupancy of the 125 lot subdivision.

Rate Determination

While the Commission has traditionally considered the original cost of the utility plant, the net investment, the capital structure, and the cost of reproduction as a going concern in the determination of fair, just, and reasonable rates; its experience in the establishment or adjustment of rates for sewage utilities has indicated that these valuation methods are not always appropriate. Sewage utilities are unique to the extent that the cost of facilities has usually been included in the cost of the individual lot. The owner and/or operator of the utility is, in many instances, the developer of the real estate and title may have changed hands prior to the effective date of Commission jurisdiction (January 1, 1975). Further, the Commission has found that the books, records and accounts of these operations are, for the most part, incomplete so as to make impossible the fixing of rates on the above methods of valuation. The Commission is, therefore, of the opinion that the "Operating Ratio Method"⁽¹⁾ should be utilized in rate-making determinations for sewage utilities although it is recognized that there may be instances where other methods or procedures could be more valid.

Findings in This Matter

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

1. That public convenience and necessity requires construction of the proposed sewage collection and treatment system for the Meadow Creek Farm Subdivision, Oldham County, Kentucky in the area set forth in the application.
2. That the construction proposed by the Applicant includes sewage collection and treatment facilities for the Meadow Creek Farm Subdivision for treatment of an ultimate capacity of 50,000 GPD to provide service for approximately 125 single-family residences.

(1) Operating ratio is defined as the ratio of expenses, including depreciation and taxes, to gross revenues.

$$\text{Operating Ratio} = \frac{\text{Operating expenses} + \text{depreciation} + \text{taxes}}{\text{Gross Revenues}}$$

3. That from the evidence entered, the Applicant plans to recover its investment in the construction of the proposed facilities by means of apportionment of the costs thereof in the sale of lots; and further, that the Applicant plans to recover the operating expenses of the sewage treatment facilities from the revenues produced by its monthly sewage service rates.

4. That the proper method to determine revenue requirements, in this instance, is the operating ratio method.

5. That the rates set forth in Appendix "A", attached hereto, and made a part hereof, are the fair, just, and reasonable rates to be charged for sewage services rendered by the Applicant. Further, that the said rates should produce gross annual revenues of approximately \$19,275 from the fully developed subdivision of 125 single-family residences.

6. That an operating ratio of approximately 0.88 will result from the estimated revenues that should be produced after the subdivision is completely developed and should provide a reasonable return margin⁽²⁾ in this instance.

7. That the rates proposed by the Applicant are unfair, unjust, and unreasonable in that they would provide gross revenues in excess of those found reasonable herein and should be denied.

8. That while traditionally depreciation on contributed property for rate-making purposes has been allowed, it has not been a matter of great significance in past years. The value of contributed property in currently operating water and sewage utilities, however, 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.

(2) Return margin is the amount remaining for the payment of a return on the investment of the security holders.

The Commission is, therefore, of the opinion and finds that depreciation on contributed property for water and sewage utilities is not justified and should not be included in rate-making determinations for these utilities. In support of this position and by way of substantiation, we make reference to the cases and decisions listed in Appendix "B" attached hereto and made a part hereof.

9. That the Applicant has filed a valid third party beneficiary agreement with this Commission.

10. That the Commission, after consideration of the Applicant's estimated proforma revenues and expenses, concludes that these revenues, expenses and adjustments thereto can be summarized as shown in Appendix "C" attached hereto and made a part hereof. On the basis of the said summary tabulation the Commission further concludes that annual revenues in the amount of \$19,275 are necessary for providing sewage collection and disposal services for the Meadow Creek Farm Subdivision.

11. That the Applicant should file with this Commission a duly verified document or documents (final invoices, etc.) which show the total costs for construction and all other capitalized costs (administrative, legal, engineering, etc.) within sixty (60) days of the date that construction is substantially completed. Further, that the documents filed should clearly separate the costs of the facilities' components as follows: (1) the collection system with pumping stations listed separately and (2) the treatment plant.

Orders in This Matter

The Commission, on the basis of the matters hereinbefore set forth, and the evidentiary record in this case:

HEREBY ORDERS that the Applicant be and it is hereby granted a Certificate of Public Convenience and Necessity for construction of a sewage collection and treatment system for the Meadow Creek Farm Subdivision, Oldham County, Kentucky as set forth in the application.

IT IS FURTHER ORDERED that the rates prescribed and set forth in Appendix "A", attached hereto and made a part hereof, be and the same are hereby fixed as the fair, just, and reasonable rates of the Applicant for services rendered on and after the date of this Order to customers located in the Meadow Creek Farm Sub-division, Oldham County, Kentucky.

IT IS FURTHER ORDERED that the rates set forth in the Applicant's petition be and the same are hereby denied.

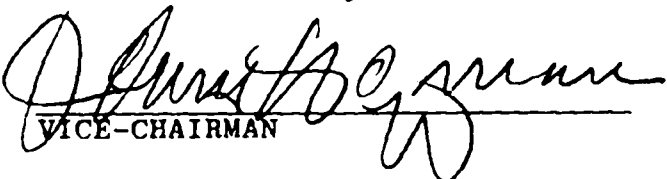
IT IS FURTHER ORDERED that the Applicant file with this Commission a duly verified document or documents which show the total cost of this project including the cost of construction and all other capitalized costs (engineering, legal, administrative, etc.) within sixty (60) days of the date of substantial completion of the proposed construction. Further, that said documents shall clearly separate the costs of the components of the system as set forth herein by Finding No. 11

IT IS FURTHER ORDERED that the Applicant shall file with this Commission, within thirty (30) days of the date of this Order, its tariff sheets setting forth the rates prescribed in Appendix "A". Further, that a copy of the Applicant's "Rules and Regulations" for providing sewage disposal services to its customers shall be filed with said tariff sheets.

Done at Frankfort, Kentucky, this 19th day of February, 1980.

UTILITY REGULATORY COMMISSION


CHAIRMAN


VICE-CHAIRMAN


COMMISSIONER

ATTEST:

SECRETARY

APPENDIX "A"

APPENDIX TO AN ORDER OF THE UTILITY REGULATORY
COMMISSION IN CASE NO. 7499 DATED FEBRUARY 19, 1980.

The following rates are prescribed for sewage disposal services rendered to all customers of the Evercliff Corporation that are located in the Meadow Creek Farm Subdivision, Oldham County, Kentucky.

<u>Type of Service Provided</u>	<u>Monthly Rate</u>
Single-Family Residential	\$12.85 per Residence
Multi-Family Residential	9.65 per Apartment

APPENDIX "B"

APPENDIX TO AN ORDER OF THE UTILITY REGULATORY
COMMISSION IN CASE NO. 7499 DATED FEBRUARY 19, 1980.

A listing of cases and decisions that substantiate finding
number 8.

- (1) 28 U.S.C. s 362(c) (1976).

Dealing with the Basis to Corporations in Reorgani-
zation. It states in part that property contributed
by nonstockholders to a corporation has a zero basis.

- (2) Easter v. C.I.R., 338 F.2d 968 (4th Cir. 1964).

Taxpayers are not allowed to recoup, by means of de-
preciation deductions, an investment in depreciable
assets made by a stranger.

- (3) Martigney Creek Sewer Co., (Mo. Pub. Serv. Comm.,
Case No. 17,117) (November 26, 1971).

For rate making purposes a sewer company should not
be allowed to treat depreciation on contributed plant
as an operating expense.

- (4) Re Incline Village General Improv. Dist., I & S 558,
I & S 559, (Nev. Pub. Serv. Comm., May 14, 1970).

Where a general improvement district sought to in-
crease water rates, the Commission could not consider
depreciation expense on the district's plant because
all of the plant had been contributed by members of
the district.

- (5) Princess Anne Utilities Corp. v. Virginia ex. rel.
State Corp. Commission, 179 SE 2d 714, (Va. 1971).

A depreciation allowance on contributions in aid of
construction was not allowed to a sewer company
operating in a state following the "original cost"
rule in determining rate base because the company
made no investment in the property, and had nothing
to recover by depreciating the donated property.

APPENDIX "C"

APPENDIX TO AN ORDER OF THE UTILITY REGULATORY
COMMISSION IN CASE NO. 7499 DATED FEBRUARY 19, 1980.

In accordance with Finding No. 10, the following tabulation is the Commission's summary of the estimated annual revenues and expenses for the Applicant's 50,000 GPD sewage collection and treatment facilities when serving 125 customers of the Meadow Creek Farm Subdivision, Oldham County, Kentucky.

	<u>Proforma(1)</u> <u>Requested</u>	<u>Proforma</u> <u>Found</u> <u>Reasonable</u>
(No. of Customers)	(125)	(125)
<u>Revenues:</u>	\$ 27,300	\$ 19,275
<u>Expenses:</u>		
1. Management & Office Exp.		
a) Managers salary	1,200	1,200
b) Bookkeeping expense	900	900
c) Office rent, light & heat	600	600
d) Office telephone	100	100
e) Supplies, postage, etc.	100	100
2. Billing and Collecting	1,500	1,500
3. Sewage System Operations		
a) Routine O & M	3,600	3,600
b) Sludge Hauling	1,020	1,020
c) Repairs and Maintenance	5,000	2,500(2)
d) Utilities - Electric	3,500	2,000(3)
e) Utilities - Water	1,250	1,000(3)
f) Chlorine & Plant Supplies	500	500
g) Health Department Fees	1,000	-0- (4)
h) NPDES Monitoring	150	150
4. Professional Services - Case #7499	1,000	-0- (5)
5. Professional Services - Annual:		
a) Accounting	600	350(6)
b) Legal	300	200(6)
c) Engineering	400	200(6)
6. Taxes:		
a) Income	150	150
b) License Fees, etc.	500	500
7. Insurance	250	250
8. Miscellaneous	<u>150</u>	<u>150</u>
Total Expenses	\$ 23,770	\$ 16,970
Net Income	\$ 3,530	\$ 2,305

- (1) Proforma requested revenues and expenses were taken from the Applicant's summary of estimated annual revenues and expenses.
- (2) The Applicant could not adequately substantiate the requested amount. A more reasonable estimate of \$2,500 has been allowed, based on actual Repair and Maintenance expenses for similar sized utilities now operating in the general area of the proposed utility.
- (3) The Applicant could not adequately substantiate the requested amounts. More reasonable estimates of \$2,000 for Electrical Expense and \$1,000 for Water Expense have been allowed, based on actual expenses for similar sized utilities now operating in the general area of the proposed utility.
- (4) The Health Department Fees of \$1,000 was disallowed. The Oldham County Health Department does not impose such fees on sewage utilities operating in Oldham County.
- (5) The rate case expense of \$1,000 was disallowed. This expense should be more appropriately accounted for as an organizational expense, in accordance with the Commission's Uniform System of Accounts.
- (6) The Applicant could not adequately substantiate the requested amounts for annual professional services. Estimates of \$350 for accounting, \$200 for legal and \$200 for engineering based on actual expenses for comparative utilities now operating in the general area of the proposed utility were found to be more reasonable allowances for these expenses.