

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF WARREN )  
COUNTY WATER DISTRICT, )  
WARREN COUNTY, KENTUCKY )  
SEEKING APPROVAL OF AN IN- )  
CREASE IN ITS SCHEDULE OF ) CASE NO. 8084  
SEWER SERVICE RATES AND )  
CHARGES, SUCH INCREASE TO BE )  
EFFECTIVE AS OF THE 5TH DAY )  
OF JANUARY 1981 )

O R D E R

On June 5, 1981, the Commission issued an Order in this case which disallowed Warren County Water District's Sewer Division ("Warren County") depreciation expense on sewer plant funded by federal grants or contributions in aid of construction. Warren County filed a motion for rehearing on June 25, 1981, which the Commission denied. Warren County appealed the Commission's decision to the Franklin Circuit Court, which remanded the case to the Commission for rehearing, on the ground that Warren County should have an opportunity, at a public hearing, to present evidence on the subject of the allowance of depreciation on contributed property for rate-making purposes. The Court of Appeals affirmed the Franklin Circuit Court. On December 10, 1982, a rehearing was held in the Commission's offices with the Consumer Protection Division of the Attorney General's Office ("AG") present and intervening in the matter. Briefs were filed

on January 3 and 31, 1983. All requested information has been submitted.

#### DISCUSSION

At the rehearing in this case, Warren County presented direct testimony by one witness, Mr. Spencer A. Coats, Certified Public Accountant with James R. Meany and Associates in Bowling Green, Kentucky, on the issue of the proper recording depreciation on the utility's books of donated or contributed assets. Mr. Coats had requested a formal ruling from the Technical Standards Department of the American Institute of Certified Public Accountants ("AICPA") on the proper recording of depreciation on contributed property. Mr. Coats received a reply dated September 11, 1981, from George Dick, Director of the Technical Information Service Division of the Technical Standards Department. Mr. Dick's reply, made a part of the record, stated that in accordance with generally accepted accounting principles, depreciation should be recorded on contributed property. Mr. Coats further referred to publications from the American Waterworks Association, a trade organization serving the water and sewer utility industry, and to the Uniform System of Accounts for Water Utilities published by the National Association of Regulatory Utility Commissioners and adopted by this Commission in 807 KAR 5:006 in compliance with KRS 278.220, both of which state that depreciation should be recorded on contributed property.

The Commission does not nor have we ever disagreed that it is proper to record depreciation on contributed property. The recording of depreciation is a method of showing on the books of

account that an asset gradually is declining in value during it's useful life. However, the determination of fair, just and reasonable rates extends beyond mere recording or the proper accounting treatment for financial transactions. The Commission is charged with the dual responsibility of setting rates that provide a utility the opportunity to collect sufficient revenues to operate on a sound financial basis and to ensure that the rates are the fair, just and reasonable rates to be charged the utility's customers.

In this regard, Warren County has not presented any evidence or persuasive arguments during the rehearing process to convince the Commission that disallowance of depreciation on contributed property for rate-making purposes in this case resulted in insufficient rates.

Mr. Coats admitted on cross-examination that he had not performed an analysis of Warren County's current or prospective financial operations. He did state for the record that Warren County was in compliance with the requirements of its bond ordinance, that he was unaware of any cash-flow problems experienced by Warren County and Warren County had not sought or been required to seek short-term financing since the Commission's Order entered June 5, 1981, in this case.

Mr. Coats objection to the disallowance of depreciation on contributed property is that no funds would be set aside to provide for replacement or improvements on that portion of utility plant funded by contributions. This situation then could conceptually require Warren County to either neglect its system or

secure outside financing of necessary replacements or improvements. Depending on the source and terms of outside financing of prospective improvements or replacements, Warren County's capital costs and thus its future rates could potentially change. It is Mr. Coats' opinion that future rates would increase. However, Mr. Coats stated that he had not performed any present value analyses nor any studies that would support his conclusion that it would ultimately be cheaper for Warren County's customers to provide currently higher rates for future replacements or improvements of plant. The Commission is of the opinion that future needs for plant replacement, the amount required should plant need replacing, and the type and cost of financing any such replacement is so speculative that, in the Commission's view, it is best left to future ratepayers.

Moreover, arguments presented in this regard ignore the fact that the Commission in establishing rates for Warren County allowed not only Warren's out-of-pocket cash requirements including principal on Warren County's debt but further allowed a margin of 20 percent above Warren County's debt service requirements and depreciation on property not funded by contributions. These additional funds over and above out-of-pocket cash requirements provide Warren County a surplus for improvements and replacements of its plant.

Finally, in its brief, Warren County cited the Court's opinion in City of Covington Vs. Public Service Commission, Kentucky, 313 S.W.2d and 391 (1958) wherein the court found that

plant funded by federal grants should be included in the utility's rate base. As pointed out by the AG in its brief, this argument applied to a rate base consideration and does not extend to the issue of depreciation on contributed property.

SUMMARY

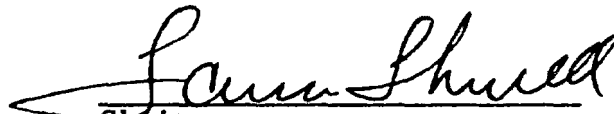
The Commission is of the opinion and finds that Warren County has not presented sufficient evidence to substantiate its claim that the Commission's Order in this case entered June 5, 1981, as modified in its Order entered July 15, 1981, should be further changed.

IT IS THEREFORE ORDERED that the rates and provisions in the Commission's Orders in this case entered June 5, and June 15, 1981, shall remain in full force and effect.

Done at Frankfort, Kentucky, this 11th day of April, 1983.

PUBLIC SERVICE COMMISSION

Vice Chairman  
Katherine Randall  
did not participate  
in this decision.

  
Chairman

Did not participate  
Vice Chairman

  
Commissioner

ATTEST:

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Secretary