

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF SDW CORPORATION )  
FOR A RATE ADJUSTMENT PURSUANT TO THE ) CASE NO. 9483  
ALTERNATIVE RATE FILING PROCEDURE )  
FOR SMALL UTILITIES )

O R D E R

On December 19, 1985, SDW Corporation ("SDW") filed an application for authority to increase rates pursuant to 807 KAR 5:076, Alternative Rate Adjustment Procedure for Small Utilities ("ARF"). SDW requested additional operating revenues of approximately \$13,021 annually, an increase of 110 percent over reported test-year operating revenues. SDW is a sewer utility serving 37 customers in the Springdale West Subdivision in Jefferson County, Kentucky. A hearing was not requested nor held in this matter.

After the adjustments and determination herein, SDW is granted authority to increase rates to produce additional operating revenue of \$5,900 annually or 49.9 percent.

Staff Audit Report

To simplify the regulatory process for this small utility, the Commission staff performed a limited financial audit for the utility's test period to verify reported expenditures and substantiate the propriety of the test-year financial statements. Some errors were discovered, and due to circumstances in the case, adjustments were made to the submitted financial statements. The

staff report was made a part of the record in this case as an appendix to the Commission's Order of March 13, 1986. No comments or objections to the staff report were received. Therefore, the adjusted financial statements have been adopted herein as the test period actual.

ADJUSTMENTS TO REVENUES AND EXPENSES FOR RATE-MAKING PURPOSES

SDW proposed, and the Commission accepts, the 12-month period ending September 30, 1985, as an appropriate test period for determining the reasonableness of the proposed rates.

The Commission has made, for rate-making purposes, the following modifications to SDW's proposed adjustments to test period revenues and expenses to reflect more normal and current operating conditions:

Revenue Normalization

In order to normalize annual operating revenues, the Commission has adjusted reported test-year operating revenues to \$11,832<sup>1</sup>, based on the the residential equivalents and the monthly rates at the end of the test year. Both SDW's annual report for 1984 and its application reflect 37 customers, 36 residential customers and 1 school rated at 22 residential equivalents.

Outside Services - Legal

SDW has included a \$125 payment to the Waste Water Treatment Council of the Home Builder's Association of Louisville ("Council") as legal services. The Council is supported by sewer plant owners in Jefferson County, and is presenting legal

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<sup>1</sup> 58 Residential Equivalents X \$17 X 12 months = \$11,832.

challenges to recent actions by the Metropolitan Sewer District. The Commission's opinion is that this expense should be borne by its owners, whose position is being defended and who would be direct beneficiaries of the rights to ownership, and not by the ratepayers. Therefore, the payment has not been allowed for rate-making purposes.

#### Outside Services - Accounting

During the test year, SDW included a \$100 payment to the Arthur Young Company for services relating to the donation of SDW stock to the Kentucky Country Day School ("Country Day"). SDW indicated that this expenditure would be of a recurring nature. However, no evidence was presented as to why this expense would be incurred again in the near future. Therefore, the Commission is of the opinion that the expenditure is of a non-recurring nature, and should not be included for rate-making purposes herein.

#### Depreciation Expense

SDW showed actual test-year depreciation expense of \$18,164, which it proposed to reduce to \$6,434. The reduction was due to the fact that some components of the utility plant were reaching a fully depreciated status. The \$6,434 represented the average expense over the next 3 years.

The depreciation claim is questionable because a review of the utility plant shows that the plant value cannot be substantiated. The initial construction of the utility plant, by Springdale Development Corporation ("Springdale") in 1975, was

approved in Case No. 6395.<sup>2</sup> The developer of Springdale indicated in the record that the plant was to be in service for approximately 4 years, when it would be replaced by a larger facility. The financing of the plant was commingled with the financing of the adjoining subdivision. The developer also indicated he did not anticipate cost recovery through the sale of lots, and he would in effect be subsidizing the plant. In order to keep his lot prices competitive, the developer agreed to forgo any depreciation expense in the designing of the sewer rates for the 4-year period. In the 1978 and 1979 Annual Reports to the Commission, there were substantial additions to plant-in-service. These plant expansions were not approved by the Commission. Evidently, it was at this time that the plant reached its current capacity of 60,000 GPD. In October of 1979, Citizen's Fidelity Bank and Trust ("Citizen's Fidelity") acquired the utility plant from Springdale for \$230,000 and took a deed in lieu of foreclosure. The plant transfer was performed so Citizen's Fidelity would not sue Springdale over existing mortgages. The sale and

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<sup>2</sup> Case No. 6395, The Application of Springdale Sanitation Systems, Inc., of Jefferson County, Kentucky, for a Certificate of Convenience and Necessity, Authorizing Said Private Corporation to Construct a Sewage Disposal and Treatment Plant Pursuant to KRS Chapter 278, and Seeking Approval of the Plans and Specifications of Said Plant and Construction Thereof, and Further Seeking Approval of the Schedule of Rates and Charges for Said Sewer Service to be Rendered by Said Treatment Plant; amended to Springdale Development Company, Inc., per hearing on November 12, 1975; dated December 17, 1975.

transfer were approved by the Commission in Case No. 7642.<sup>3</sup> The record in that case was not clear as to whether the purchase price of \$230,000 related solely to the plant or to other indebtedness of Springdale. Citizen's Fidelity revised the recorded costs of the utility plant to match the purchase price and began a new depreciation schedule for all components of the utility plant, including the land. In September 1984, the utility plant was sold by Citizen's Fidelity to SDW for \$131,040. The sale and transfer were approved by the Commission in Case No. 9089.<sup>4</sup> The record in that case was not clear as to how SDW secured the purchase price, whether it was by the assumption of outstanding debt related to the plant, or through the donation of funds by an interested party. SDW was ordered to file the appropriate journal entries recording the purchase. The submitted entries did not conform with the Uniform System of Accounts for Class C and D Sewer Utilities ("Uniform System of Accounts"). Subsequent to the

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<sup>3</sup> Final Order dated March 5, 1980, Case No. 7642, The Joint Application of Springdale Development Corporation, a Kentucky Corporation, "Seller" and Citizen's Fidelity Bank and Trust Company, d/b/a Citizen's Fidelity Mortgage Company, a Corporation, "Purchaser" for Approval of the Kentucky Utility Regulatory Commission of the Sale and Transfer of the Sewerage Treatment Plant and System Serving Springdale West, Jefferson County, Kentucky.

<sup>4</sup> Final Order dated September 26, 1984, Case No. 9089, The Joint Application of Citizen's Fidelity Bank and Trust Company, d/b/a Citizen's Fidelity Mortgage Company, a Corporation, ("Seller"), and SDW Corporation, a Kentucky Corporation ("Purchaser"), for Approval of the Kentucky Public Service Commission of the Sale and Transfer of the Sewerage Treatment Plant and System Serving Springdale West, Jefferson County, Kentucky.

September 1984 transfer, the recorded costs of the utility plant were revised again to match the purchase price, and a new depreciation schedule was started for the depreciable assets.

On December 31, 1984, the sole shareholder of SDW, David A. Jones, donated all of the SDW stock to Country Day. In the charitable contribution agreement ("Agreement") not only was the stock transferred, but Country Day accepted the SDW assets without any warranties or guarantees. This statement would appear to indicate that this transaction involved more than a stock transfer. Also in the Agreement, Country Day agreed that they would secure any necessary governmental approvals, including this Commission's, for the transfer. No such approval has been sought by Country Day or SDW.

In summary, the claim for depreciation is complicated by several issues. The improper accounting treatments, which did not conform with the Uniform System of Accounts, utilized in the prior transfers make it impossible to establish the utility plant's original cost. The utility plant currently recorded on SDW's books cannot be distinguished between the original plant and the unapproved expansions. The utility plant and accumulated depreciation reported by SDW in their 1984 and 1985 Annual Reports do not agree with the figures presented in the current application. The utility plant is currently utilizing only 38.7 percent<sup>5</sup> of its capacity. Finally, the current owner of SDW, Country Day,

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<sup>5</sup> 58 Residential Equivalents X 400 Gallons = 23,200 ÷ 60,000 GPD = 38.666%.

has no investment in the utility since the utility was acquired through a charitable donation.

Because the original cost of the utility plant cannot be established, as well as the existence of several related questions concerning prior accounting treatment, no depreciation expense has been allowed for rate-making purposes herein. However, if SDW can provide the necessary verifications and clarifications concerning the utility plant and accumulated depreciation, it may seek a rehearing on this issue.

#### Taxes Other Than Income Taxes

SDW reported Taxes Other Than Income Taxes of \$1,365, which included the 1984 franchise tax payment of \$1,030. The remaining \$335 in taxes was for 1985 tax liabilities. This timing difference was caused by the test year selected by SDW. The 1985 plant assessment was presented in the application. Upon application of the Jefferson County tax rates to the 1985 plant assessment, the franchise tax for 1985 is computed to be \$1,014. Therefore, the franchise tax portion of Taxes Other Than Income Taxes will be \$1,014, included herein for rate-making purposes.

#### Other Deductions

Test year expense included \$57 for debt repayment interest, for an on demand loan made by Country Day during the test year to cover the operating losses of SDW. The burden of obtaining sufficient revenues to meet operating costs rests with the utility. The Commission is of the opinion that to include interest on debt obtained to pay operating costs constitutes retroactive rate-

making. Therefore, the Commission will not include the interest charges of \$57 for rate-making purposes herein.

Collection Fee

SDW projected expenses of \$306 related to the collection of its bimonthly sewer bill by the Louisville Water Company. The adjustment is based on the proposed rate as a percentage of the total sewer and water bill multiplied by the collection charge per bill. The Commission noted that SDW used data from a 4-month period in its computation, rather than the 12-month test year, data. The Commission has computed SDW's pro forma collection expense based upon the 12-month data and the rate allowed herein, which results in an expense of \$295.

After consideration of the aforementioned adjustments, the Commission finds SDW's test period operations to be as follows:

	<u>Actual Test Period</u>	<u>Commission Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$ 11,811	\$ 21	\$ 11,832
Operating Expenses	31,523	<15,919>	15,604
Net Operating Income	<u>\$&lt;19,712&gt;</u>	<u>\$ 15,940</u>	<u>\$ &lt;3,772&gt;</u>
Other Deductions	57	<57>	0
Net Income	<u><u>\$&lt;19,769&gt;</u></u>	<u><u>\$ 15,997</u></u>	<u><u>\$ &lt;3,772&gt;</u></u>

REVENUE REQUIREMENTS

Operating Ratio

SDW requested an operating ratio of 88 percent on total operating expenses and taxes of \$22,433. The Commission finds that an operating ratio of 88 percent will allow SDW to pay its operating expenses and provide a reasonable surplus. The use of an 88 percent operating ratio applied to the adjusted test-year



operating expenses of \$15,604 results in a revenue requirement of \$17,732. Therefore, the Commission finds that SDW is entitled to an increase in revenues of \$5,900 annually.

#### OTHER ISSUES

##### Transfer of Ownership

As was noted in the discussion on depreciation expense, SDW purchased its utility plant from Citizen's Fidelity in September 1984. On December 31, 1984, the sole shareholder of SDW's stock, David A. Jones, and Country Day entered into a charitable contribution agreement, whereby all SDW stock was donated to Country Day. Country Day accepted the stock of SDW and agreed to obtain this Commission's approval for the stock transfer. In a letter dated March 18, 1985, from the Commission's Engineering Division, Country Day was reminded that the Commission's approval of the stock transfer was necessary. Again, during the staff audit on February 24, 1986, Country Day was told of the need for Commission approval of the stock transfer. As of this date, neither SDW nor Country Day has submitted an application for the approval of the stock transfer. The Commission believes that such an application for approval is necessary. However, the Commission will deviate from its standard procedure and grant the transfer in this case.

##### Accounting Records

Also noted in the depreciation expense discussion was the fact that the accounting entries submitted by SDW to record the purchase of the utility plant were not in conformity with the Uniform System of Accounts. The staff audit report of March 13,

1986, noted the books of SDW were not maintained in conformity with the Uniform System of Accounts.

#### SUMMARY

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

1. The rates proposed by SDW would produce revenue in excess of that found reasonable herein and, therefore, should be denied upon application of KRS 278.030.

2. The rates in Appendix A are the fair, just and reasonable rates for SDW in that they are calculated to produce gross annual revenues of \$17,732. These revenues will be sufficient to meet SDW's operating expenses found reasonable for rate-making purposes and provide a reasonable surplus.

3. The approval by this Commission of the stock transfer of SDW to Country Day has not been sought. However, it is in the best interests of the customers of SDW that the transfer be approved. Country Day is ready, willing and able to operate and provide adequate and reliable service to the customers of SDW. The quality of service to the present customers will not suffer in that the company operating the utility plant has not been changed.

4. The accounting records of SDW should be revised and maintained in accordance with the Uniform System of Accounts prescribed by this Commission. The accounting for SDW's acquisition of the utility plant should include:

a. Recording the utility plant acquired at its original cost to the person first devoting it to public service,

estimated if not known, in the appropriate utility plant-in-service accounts.

b. Crediting the requirements for accumulated provision for depreciation and amortization applicable to the original cost of the properties acquired to the appropriate account for accumulated provision for depreciation and amortization.

c. Transferring the cost of any nonutility property to Account No. 121--Nonutility Property.

d. Crediting contributions in aid of construction, estimated if not known, to Account No. 271--Contributions in Aid of Construction.

e. Including in Account No. 108--Utility Plant Acquisition Adjustment, any difference between the purchase price and the original cost of the utility plant and nonutility property less the amounts credited to accumulated depreciation and amortization reserves and contributions in aid of construction.

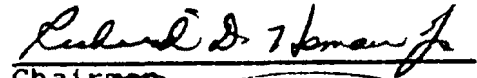
IT IS THEREFORE ORDERED that:

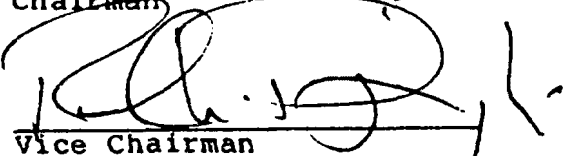
1. The rates proposed by SDW are denied.
2. The rates in Appendix A are approved for service rendered by SDW on and after the date of this Order.
3. Within 60 days from the date of this Order, SDW shall file with this Commission copies of the journal entries recording SDW's purchase of the utility plant, in accordance with the Uniform System of Accounts; SDW shall also supply evidence that its accounting records have been revised in accordance with the Uniform System of Accounts.

4. Within 30 days from the date of this Order, SDW shall file with this Commission its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 15th day of May, 1986.

PUBLIC SERVICE COMMISSION

  
Chairman

  
Vice Chairman

  
Commissioner

ATTEST:

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Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 9483 DATED 5/15/86

The following rates and charges are prescribed for customers receiving sewer service from SDW Corporation. 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.

Monthly Rate

<u>Customer Class</u>	<u>Rate</u>
Single Family Residential	\$25.50*
Apartment	21.25**
All Other	25.50***

\* Per Residence

\*\* Per Apartment Unit

\*\*\* Per Residential Equivalent

Residential Equivalent is defined as 400 Gallons Per Day.