

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF HIGHLAND CLUB )  
ESTATES, FOR AUTHORITY TO ACQUIRE )  
AND OPERATE THE ASSETS OF THE ) CASE NO. 9558  
HIGHLAND CLUB ESTATES SEWER SYSTEM )  
IN GRAVES COUNTY, KENTUCKY )

O R D E R

On April 4, 1986, Highland Club Estates ("Applicant") filed an application seeking authority to acquire and operate the Highland Club Estates Sewer System ("Highland Club Sewer System") formerly owned by Red Wing Utility Company, Inc. ("Red Wing").

A public hearing was not held and no additional information has been requested in this case.

COMMENTARY

The Application states that the Highland Club Sewer System is the subject of litigation before the Graves Circuit Court, that a Quitclaim Deed has been executed in favor of Pavco, Inc. ("Pavco"), and that on approval of this application, Pavco will convey this property to the Applicant.

In Case No. 7371,<sup>1</sup> the Commission found that Red Wing's management had demonstrated that it was not capable of providing

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<sup>1</sup> Final Order dated May 15, 1981, Case No. 7371, Redwing Utility Co., Inc. Application and Petition for an Order Approving Uniform Sewage Service Rates for the Sewage Treatment Facilities Located in Highland Club Estates Subdivision, Mayfield, Graves County, Kentucky.

efficient, prudent and reasonable utility operations and ordered the third-party beneficiary agreement invoked. In that proceeding, the Commission questioned the reliableness of the financial data presented by Red Wing and the basis for allocating operating expenses common to Red Wing and an affiliate. Therefore, the Commission has determined that the transfer is in the best interest of the customers.

However, based on the application, it is apparent to the Commission that the potential exists for commingling of assets and expenses of the utility and other commonly-owned business entities. The Applicant stated that a separate account fund and separate books of account would be maintained for the utility; that these would be maintained in accordance with the Uniform System of Accounts for Sewer Utilities ("USoA"), prescribed by the Commission; that Robert Woodsmall will be the manager and that the personnel, equipment, bookkeeping and management skills of Pavco would be of use in attending the facility.

Pavco is a construction firm in which the partners of Highland Club Estates, the Applicant, have business interests. In addition, Robert Woodsmall, who will manage the system, is an officer of Pavco. Since the USoA requires that separate records be maintained for utility operations, Applicant is hereby notified that since employees and facilities of a non-regulated business will be shared, it will be essential to keep records adequately detailed to allocate or specifically identify the expenses of the Applicant and those of other affiliated businesses.

Applicant should file with the Commission, no later than 90 days from the date of this Order, a plan detailing the manner in which it proposes to account for and allocate the expenses. To facilitate the recordkeeping and allocation requirements, the Commission suggests that Applicant consider a written operating or service agreement that can establish the basis for expense allocation. The Commission staff is available to assist with the details of such an agreement should Applicant need assistance in designing an arrangement that would be acceptable for accounting purposes.

Applicant has also proposed the accounting entries to record the purchase. In Case No. 7568,<sup>2</sup> Robert Woodsmall, a developer of Highland Club Estates, testified that the developers agreed to put in the sewer system and give it to Red Wing. Based on the evidence of record and the annual reports on file, the Commission finds that the proposed entries are not in accordance with the USOA. Accounting for an acquisition, in accordance with the USOA includes:

1. 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;

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<sup>2</sup> Final Order dated October 31, 1980, Case No. 7569, Application of Red Wing Company, Inc. for an Increase in Rates for the Sewage Treatment Facilities Located in Gateway Subdivision, Marshall County; Golden Acres Subdivision, Marshall County; Blandville Estates, McCracken County; Green Acres Subdivision, McCracken County; Fieldmont Estates, McCracken County; Hollifield Estates, Graves County.

2. 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;

3. Transferring the cost of any nonutility property to Account 121, Nonutility Property;

4. Crediting contributions in aid of construction to Account 271, Contributions in Aid of Construction; and

5. Including in Account 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.

Therefore, the Commission has determined that the following entries should be reflected on Applicant's books to record the effects of the transfer:

Utility Plant Purchased or Sold	\$ 1,500	
Cash		\$ 1,500

    To record the purchase.

Plant in Service	\$60,740	
Utility Plant Purchased or Sold		\$60,740

    To record the original cost of the plant.

Utility Plant Purchased or Sold	\$19,994	
Accumulated Provision for Depreciation		\$19,994

    To record the accumulated depreciation through June 30, 1986.

Utility Plant Purchased or Sold	\$60,740	
Contributions in aid of Construction		\$60,740

To record the contributions  
associated with the plant.

Utility Plant Acquisition Adjustment	\$21,494	
Utility Plant Purchased or Sold		\$21,494

To record the acquisition  
adjustment.

In its determination of the entries that should be reflected on Applicant's books, the Commission has based its calculations on the following information:

1. The original cost of \$60,740 as reported by Red Wing in the 1980 Annual report.
2. Depreciation has been computed from December 31, 1979, through June 30, 1986, based on a 20-year life.
3. The entire original cost of the plant was contributed by the developers to Red Wing.

In lieu of a third-party beneficiary agreement, Applicant has filed a letter of credit in the amount of \$1,000 stating that this amount should be adequate to operate the system for 6 months. This letter of credit expires March 31, 1987. The Commission generally requires a third-party beneficiary agreement in order to assure continuous operation of sewage treatment facilities. However, in the absence of accurate historical operating expenses and based upon the fact that the partners in Highland Club Estates also own the subdivision served by Applicant, the Commission has determined that sufficient evidence of financial integrity has

been demonstrated for the period covered by this letter of credit. Applicant is hereby notified that within 90 days from the date of this Order a copy of a valid third-party beneficiary agreement, a letter of credit coextensive with the operation of the utility under the ownership of Applicant or other evidence of financial integrity that will ensure the continuity of sewage service beyond March 31, 1987, should be filed.

#### SUMMARY

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

1. Applicant is ready, willing and able to own, operate and provide adequate and reliable service to the customers presently served by Highland Club Sewer System.

2. Pavco will convey the total plant to Applicant in exchange for Applicant's investment of \$1,500.

3. Applicant has adopted the tariffs, rates, rules and regulations filed with the Commission by Red Wing for furnishing sanitary sewer service to its customers and these are the only rates, rules and regulations approved by the Commission.

4. A third-party beneficiary agreement for this sewage treatment facility has not been entered into but sufficient evidence of financial integrity has been shown by alternative means through March 31, 1987.

5. Applicant shall file a copy of a valid third-party beneficiary agreement, a letter of credit coextensive with the operation of the utility under the ownership of Applicant or other

evidence of financial integrity that will insure continued sewage service beyond March 31, 1987.

6. Applicant should maintain its books of account in accordance with the USoA prescribed by this Commission.

7. The accounting entries to record the purchase as proposed by Applicant are incorrect and should be those set forth herein. If Applicant proposes to deviate from the entries set forth, the proposed entries and reason for deviation should be filed with the Commission within 30 days from the date of this Order.

8. Applicant should file a plan with the Commission detailing the manner in which it proposes to account for the operations of the utility, including the allocation of expenses, within 90 days from the date of this Order.

9. The transfer of the assets should be approved since Applicant is ready, willing and able to own and operate the sewage treatment facilities.

IT IS THEREFORE ORDERED that:

1. The transfer of assets to Applicant be and it hereby is approved.

2. Applicant shall file with this Commission, within 90 days of the date of this Order, a copy of a valid third-party beneficiary agreement, a letter of credit coextensive with the operation of the utility under the ownership of Applicant or other evidence of financial integrity that will insure continued sewage service beyond March 31, 1987.

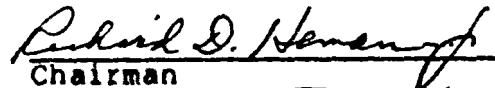
3. Applicant shall account for this transfer in accordance with the Uniform System of Accounts for Sewer Utilities prescribed by this Commission as described in this Order.

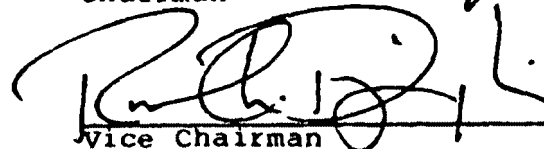
4. Applicant shall file a plan with the Commission detailing the manner in which it proposes to account for the operations of the utility within 90 days from the date of this Order.

5. Applicant shall file with this Commission within 30 days of the date of this Order its original tariff sheets setting forth its rates, rules and regulations as required by KRS 278.160.

Done at Frankfort, Kentucky, this 11th day of July, 1986.

PUBLIC SERVICE COMMISSION

  
Chairman

  
Vice Chairman

  
Commissioner

ATTEST:

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Secretary