

COMMONWEALTH OF KENTUCKY  
BEFORE THE UTILITY REGULATORY COMMISSION

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In the Matter of:

AN ADJUSTMENT OF RATES OF )  
BLUEGRASS DISPOSAL CORPORATION ) CASE NO. 7502

O R D E R

Preface

On June 27, 1979, Bluegrass Disposal Corporation hereinafter referred to as the "Utility", filed with this Commission its duly verified application seeking an increase in its sewage service rates. In a Motion accompanying it's application, the Utility further requested Commission approval of the immediate implementation of the proposed rates on an emergency basis. The Utility serves residents in the subdivisions of Boralto; Bluegrass Hills; Brigadoon, Devondale; Donnabrook; Lansbrook; Maedor; Pickway; South Point; and Stonebrook, all located in Lexington, Fayette County, Kentucky.

The case was set for hearing at the Commission's offices in Frankfort, Kentucky, August 13, 1979. All parties of interest were notified with the Consumer Protection Division of the Attorney General's Office permitted to intervene in the matter. At the hearing, certain requests for additional information were made by the Attorney General's Office and the Commission Staff. This information has been filed and made a part of the record in this matter.

The Commission, after consideration of the Utility's Motion for immediate implementation of its proposed rates on an emergency basis, the evidence submitted for substantiation of this Motion, and being advised, concluded that the Utility failed to substantiate the existence of an emergency with regard to its credit or operations pursuant to KRS 278.190(2) and denied the Motion by Interim Order dated September 12, 1979.

On November 20, 1979, the Utility filed with the Commission a Notice of its intent to place its proposed rates in effect on December 1, 1979. The Commission refuted this Notice pursuant to KRS 278.180 which requires that the Commission be given twenty (20) days notice of a change in rates. Subsequently, on November 29, 1979, the Utility filed an Amended Notice stating its intent to place the proposed rates in effect on January 1, 1980. The Commission's Order of November 30, 1979 in response to the Amended Notice, ordered that the proposed rates be suspended from January 1, 1980 to April 27, 1980.

On March 3, 1980, the Utility filed with the Commission a Notice of its intent to place the proposed rates into effect on April 1, 1980. By letter, the Commission reminded the Utility of its Order of November 30, 1979 which suspended the proposed rates until April 27, 1980. The Utility's letter of response of March 28, 1980 emphasized its extreme financial crisis and restated its intent to implement its proposed rates on April 1, 1980. The Commission, by letter dated March 31, 1980, again reminded the Utility of its Order of November 30, 1979 which suspended the proposed rates to April 27, 1980.

Pursuant to the conclusion that all requested information and other pertinent matters have been filed, the entire matter is now considered to be fully submitted for a final determination by this Commission.

#### Test Period

The Utility has selected the twelve (12) month period ending March 31, 1979 as the "Test-Year" and has submitted tabulations of its revenues and expenses for this period including its proforma adjustments thereto for the Commission's consideration in the determinations of rate adjustments. Said tabulations along with those found reasonable by this Commission are included in Appendix "C" of this Order.

#### Rate Determination

While the Commission has traditionally considered the original cost of utility plant, depreciation of the plant, the net investment, and the capital structure, 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 change 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 utilities 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"<sup>(1)</sup> should be utilized in rate-making determinations for sewage utilities although it is recognized that there may be instances where the method would not be 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 in this instance, the determination of rates and revenue requirements should be based on the operating ratio method.
2. That the rates prescribed and set forth in Appendix "A", attached hereto and made a part hereof, should produce annual revenues of approximately \$198,759 from 1,880 customers and are the fair, just, and reasonable rates to be charged for sewage services rendered by the Utility.
3. That the revenues produced by the rates approved herein should result in an operating ration of .878 and should provide a reasonable return margin<sup>(2)</sup> in this instance.
4. That the rates proposed by the Utility are unfair, unjust, and unreasonable in that they would produce revenues in excess of those found reasonable herein and should be denied.

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

$$\text{Operating Ratio} = \frac{\text{Operating Expenses} + \text{Depreciation} + \text{Taxes}}{\text{Gross Revenues}}$$

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

5. 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.

It is also recognized that many residential and commercial developments in metropolitan areas are served by privately-owned sewage systems. Further, that federal guidelines will require the incorporation of these sewage systems into a regional comprehensive sewer district at such time as connecting trunk lines are made available. Further that to permit the accumulation of a depreciation reserve on contributed property that is to be abandoned would not, in our opinion, be in the public interest.

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.

6. That the Commission, after consideration of the tabulation of test-year and projected revenues and expenses submitted by the Utility, concludes that these revenues, expenses and adjustments can be summarized as shown in Appendix "C", attached hereto and made a part hereof. On the basis of the said Appendix "C" tabulation, the Commission further concludes that annual revenues in the amount of \$198,759 are necessary and will permit the Utility to meet its reasonable expenses for providing sewage collection and disposal service to 1,880 customers.

Orders In This Matter

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

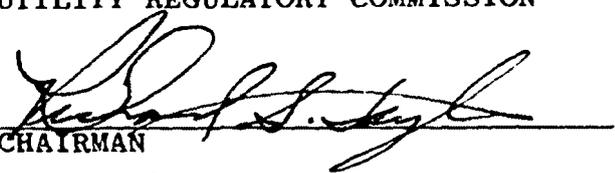
HEREBY ORDERS that the rates prescribed and set forth in Appendix "A", attached hereto and made a part hereof be and they are hereby fixed as the fair, just, and reasonable rates of the Utility for providing sewage disposal services to customers located in Fayette County, Kentucky, to become effective for services rendered on and after the date of this Order.

IT IS FURTHER ORDERED that the rates sought by the Utility be and the same are hereby denied.

IT IS FURTHER ORDERED that the Utility file with this Commission, within thirty (30) days from the date of this Order, its tariff sheets setting forth the rates approved herein. Further, that a copy of the Utility's Rules and Regulations for providing services to its customers shall be filed with said tariff sheets.

Done at Frankfort, Kentucky, this 25th day of April, 1980.

UTILITY REGULATORY COMMISSION

  
CHAIRMAN

  
VICE-CHAIRMAN

  
COMMISSIONER

ATTEST:

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SECRETARY

APPENDIX "A"

APPENDIX TO AN ORDER OF THE UTILITY REGULATORY  
COMMISSION IN CASE NO. 7502 DATED APRIL 25, 1980.

The following rates are prescribed for sewage disposal services rendered to all customers served by the Blugrass Disposal Corporation in Fayette County, Kentucky:

<u>Type of Service Provided</u>	<u>Monthly Rate</u>
Single-Family Residential	\$7.25 per Dwelling Unit
Multi-Family Residential	
a) 3-Bedroom Dwelling	7.25 per Dwelling Unit
b) 2-Bedroom Dwelling	5.45 per Dwelling Unit
d) 1-Bedroom Dwelling	3.65 per Dwelling Unit
All Other	8.30 per Residential Equivalent <sup>(1)</sup>

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(1) The number of residential equivalents and/or fractional parts thereof shall be determined by dividing the customer's average monthly water consumption in gallons by 12,000 gallons. The minimum bill for this type of service shall be \$8.30.

APPENDIX "B"

APPENDIX TO AN ORDER OF THE UTILITY REGULATORY  
COMMISSION IN CASE NO. 7502 DATED APRIL 25, 1980.

A listing of cases and decisions that substantiate Finding  
Number 5.

- (1) 28 U.S.C. § 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 maing 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. 7502 DATED APRIL 25, 1980.

In accordance with Finding No. 6, the following tabulation is the Commission summary of the "Test-Year" and projected annual revenues and expenses for the Utility's 570,000 GPD sewage collection and treatment system for providing service to test-year and proforma customers.

	Test Year(1) Ending <u>3/31/79</u>	Proforma(1) <u>Requested</u>	Proforma Found <u>Reasonable</u>
(No. of Customers)	(1,880)	(1,880)	(1,880)
<b><u>Revenues:</u></b>			
a) Income from Service	\$182,797	\$226,390	\$198,759
b) Interest Income	415	415	415
c) Copier Rental	<u>462</u>	<u>463</u>	<u>463</u>
<b>Total Revenues</b>	<b>\$183,675</b>	<b>\$227,268</b>	<b>\$199,637</b>
<b><u>Expenses:</u></b>			
1. Collection System Maintenance	\$ 2,988	\$ 3,325	\$ 2,988(2)
2. Pumping System			
a) Operation Supervision	6,906	6,906	6,906
b) Fuel & Power for Pumping	5,356	6,160	5,554(3)
c) Pumping Labor	4,619	5,125	4,619(2)
d) Maintenance	1,798	2,000	1,798(2)
3. Treatment & Disposal System			
a) Operation Supervision	29,719	27,379	26,719(4)
b) Chemicals	7,860	8,065	8,822(5)
c) Treatment Labor	13,856	15,380	13,856(2)
d) Electric Power	3,472	3,995	3,598(3)
e) Contract Treatment	13,712	13,712	13,712
f) Dumping Fees & Dumpster Service	2,188	2,188	2,188
g) Treatment Plant Maintenance	6,392	7,105	6,392(2)
h) Plant Supplies	950	1,055	950(2)
i) Water	133	133	133
j) Miscellaneous	929	929	929
k) Truck Operation	2,360	2,650	2,650
l) Truck Maintenance	1,272	1,415	1,272(2)
4. Customer Accounts			
a) Labor	8,750	9,715	8,750(2)
b) Supplies & Expenses	883	980	883(2)
c) Postage	2,517	2,517	2,517
d) Equipment Rental & Repair	450	450	450
e) Bad Debts	8,038	2,010	2,010
f) Computer Billing Service	13,588	13,670	13,670
g) Transportation	<u>251</u>	<u>275</u>	<u>275</u>
<b>Subtotals</b>	<b>\$138,987</b>	<b>\$137,139</b>	<b>\$131,641</b>

	Test Year Ending 3/31/79	Proforma Requested	Proforma Found Reasonable
<u>Expenses: (Con't)</u>			
Subtotals Carried Forward	\$138,987	\$137,139	\$131,641
5. Administrative & General			
a) Salaries	16,400	7,660	6,900(10)
b) Office Supplies	1,262	1,400	1,262(2)
c) Office Rent	1,980	1,980	1,980
d) Office Utilities	655	755	679(3)
e) Telephone	3,475	730	730
f) Legal Fees-Annual	5,000	2,000	2,000
g) Accounting Fees-Annual	3,213	1,250	1,250
h) Engineering Fees-Annual	3,029	1,000	1,000
i) General Insurance	4,136	4,136	4,136
j) Employee Insurance	2,248	1,788	1,788
k) Temporary Help	444	444	444
l) Dues & Subscriptions	156	156	156
m) Contributions	125	125	125
n) Miscellaneous	336	300	300
o) Loss (gain) on Sale of Equipment	[12]	-0-	-0-
p) Operating Taxes	15,735	15,894	15,735(6)
6. Depreciation	32,303	13,215	-0-(7)
7. Rate Case Amortization	11,881	2,833	2,833
8. Interest	10,839	2,700	-0-(8)
9. State & Local Income Taxes	-0-	1,991	1,575(9)
Total Expenses	\$252,192	\$197,496	\$174,534
Net Income (Loss)	[\$ 68,517]	\$ 29,772	\$ 25,103

(1) "Per Books" and "Proforma Requested" income and expenses were taken from the Applicant's Comparative Income Statement.

(2) The expenses for Items 1-Collection System Maintenance; 2(c)-Pumping Labor; 2(d)-Maintenance of Pumping System; 3(c)-Treatment Labor; 3(g)-Treatment Plant Maintenance; 3(e)-Truck Maintenance; 4(b)-Customer Accounts-Supplies and Expenses; and 5(b)-Administrative & General-Office Supplies, were collectively reduced to actual test year expenditures as the Utility failed to sufficiently justify the requested proforma increases. The inflation factor and projected increases presented by the Utility were speculative, at best, and were not considered by this Commission to be reasonable, known, and measurable adjustments to test year expenses.

(3) The expenses for Items 2(b)-Fuel and Power for Pumping; 3(d)-Electric Power; and 5(d)-Office Utilities were increased by an amount equal to the rate increase granted Kentucky Utilities on December 20, 1978 (Case No. 7163). The 4.953% increase was multiplied by 75% of the test year expenses to determine the proforma increase since the Utility's test year reflected 25% of the annual increase.

(4) Operation Supervision expense was calculated by adding the T. M. Regan service fee of \$20,719 to the \$6,000 manager fee for a total of \$26,719. The cost of living increase was considered to be speculative, at best, and was not considered by this Commission to be a reasonable, known, and measurable adjustments to test-year expenses.

(5) The proforma expense allowance for chemicals was determined by increasing the test-year expense by 12.25%. This increase was derived from invoices paid by the Utility to PBS Chemical Company.

(6) Operating Taxes were reduced to test-year figures as the basis for this adjustment was an increase in payroll taxes due to the requested increase in employee wages which has been disallowed herein.

(7) Depreciation in the amount of \$13,215 was disallowed in full in accordance with Finding No. 5, as the record indicates that the Utility has no depreciable non-contributed plant in service.

(8) Interest Expense in the amount of \$2,700 has been disallowed in full. The record shows that current interest charges were incurred to make distributions and loans to stockholders and officers. The Commission concludes that to allow this expense be borne by the rate payer would be improper and has disallowed this expense in this instance.

(9) State and Local Income Taxes were reduced by \$416 in accordance with the revenues found reasonable herein.

(10) Administrative and General Salaries were reduced in accordance with those salaries found reasonable in a prior Order (No. 6991) from this Commission. The inflation factor and requested increase presented by the Utility were speculative, at best, and were not considered by this Commission to be reasonable, known, and measurable adjustments to test year expenses.