

COMMONWEALTH OF KENTUCKY
BEFORE THE UTILITY REGULATORY COMMISSION

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In the Matter of:

THE APPLICATION FOR A NEW CERTIFICATE)
OF CONVENIENCE AND NECESSITY AND A)
REVISION TO THE SANITARY SEWER RATES) CASE NO. 7541
FOR THE TREASURE ISLAND EAST SUB-)
DIVISION IN JEFFERSON COUNTY, KENTUCKY)

O R D E R

Preface

On August 13, 1979, the Baldwin-United Mortgage Company, hereinafter referred to as the Utility, filed with this Commission its petition seeking a Certificate of Public Convenience and Necessity authorizing the expansion of its existing sewerage facilities and approval of a proposed adjustment in its rates for providing sewage disposal services to customers located in the Treasure Island East Subdivision, Jefferson County, Kentucky.

The case was set for hearing at the Commission's offices in Frankfort, Kentucky, November 29, 1979. All parties of interest were notified with the Consumer Protection Division of the Attorney General's Office intervening in the matter. At 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 final determination by this Commission.

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

Test Period

The Utility has selected the twelve month period ending June 30, 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 determination 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, the net investment, the capital structure and the cost of reproduction as a going concern, in determining 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 does not require construction of the proposed additions to the existing Treasure Island East Sewerage facilities locate in the Treasure Island East Subdivision, Jefferson County, Kentucky, as set forth in the Application.
2. That the construction project proposed by the Utility includes expansion of its existing 100,000 GPD sewage collection and treatment system to a capacity of 200,000 GPD to provide sewage disposal services for an additional 250 subdivision lots proposed for development in the Treasure Island East Subdivision. Further that the Utility's existing customer count and proforma projections do not indicate that the proposed construction is needed as of the date of this Order or the near future.

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

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

3. That in this instance, the determination of rates and revenue requirements should be based on the operating ratio method.

4. That the existing rate of the Utility produced total revenues of \$1,770 from an average of 25 customers receiving sewage disposal services during the test year. Further, that the Utility's expenses of \$6,787 for this period resulted in a test year deficit of \$5,017.

5. That the rates as prescribed and set forth in Appendix "A", attached hereto and made a part hereof, should produce gross annual revenues of \$33,000 from 250 customers and are the fair, just, and reasonable rates to be charged for sewage services rendered by the Utility to customers located in its service area.

6. That the rates proposed by the Utility are unfair, unjust, and unreasonable in that they could produce revenues in excess of those found reasonable herein and should be denied.

7. That an operating ratio of approximately .88 will result from the revenues produced and should provide a reasonable return margin⁽²⁾ in this instance.

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.

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.

(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 Commission, after consideration of the tabulations of test-year and projected revenues and expenses submitted by the Utility, concludes that said revenues, expenses and proforma adjustments thereto 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 \$33,000 are necessary and will permit the Utility to meet its reasonable expenses for providing sewage collection and disposal services for its 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 Utility be and it is hereby denied a Certificate of Public Convenience and Necessity to construct the proposed 100,000 GPD addition to the existing 100,000 GPD Treasure Island East Sewage collection and treatment system in Jefferson 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 they hereby are fixed as the fair, just, and reasonable rates of the Utility to be charged for services rendered on and after the date of this Order to customers located in the Meadow Creek Farm Subdivision, Jefferson County, Kentucky.

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

IT IS FURTHER ORDERED that the Utility shall file with this Commission, within thirty (30) days of the date of this Order, its

APPENDIX "A"

APPENDIX TO AN ORDER OF THE UTILITY REGULATORY
COMMISSION IN CASE NO 7541 DATED April 3rd, 1980

The following rates are prescribed for sewage services rendered by the Baldwin-United Mortgage Company to its customers located within the area platted as the Treasure Island East Subdivision, in Jefferson County, Kentucky.

<u>Type of Service Provided</u>	<u>Monthly Rate</u>
Single-Family Residential	\$11.00 per Residence
Multi-Family Residential	\$ 8.25 per Apartment
All Other	\$21.00 per Residential Equivalent ⁽¹⁾

(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 service shall be \$11.00.

APPENDIX "B"

APPENDIX TO AN ORDER OF THE UTILITY REGULATORY
COMMISSION IN CASE NO. 7541 DATED April 3, 1980

A listing of cases and decisions that substantiate finding
number 7.

- (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. 7541 DATED April 3, 1980

In accordance with Finding No. 9, the following tabulation is the Commission's summary of "Test Year" and projected annual revenues and expenses for the Utility's 100,000 GPD sewage treatment facilities which will serve 250 customers in Jefferson County, Kentucky.

	Test Year ⁽¹⁾ 7/01/78 - 6/30/79	Proforma ⁽¹⁾ Requested	Proforma Found Reasonable
Capacity of System	100,000 GPD	200,000 GPD	100,000 GPD
Capacity in Operation	100,000 GPD	100,000 GPD	100,000 GPD
No. of Customers	25	250	250
<u>Revenues:</u>	\$ 1,770	\$ 48,560	\$ 33,000
<u>Expenses:</u>			
1. Management & Office			
a) Managers salary	-0-	1,200	1,200
b) Bookkeeping	-0-	960	960
c) Office rent, light & heat	-0-	1,200	1,200
d) Telephone	-0-	144	144
e) Supplies, postage, etc.	-0-	240	240
2. Billing and Collecting	-0-	1,755	1,755
3. Sewerage Operations:			
a) Routine O & M	1,000	8,550	4,200 ⁽²⁾
b) Sludge hauling	-0-	1,020	1,020
c) Repairs and maintenance	1,102	2,607	2,607
d) Utilities - Electric	2,265	15,000	8,000 ⁽³⁾
e) Utilities - Water	1,589	2,250	2,250
f) Chlorine & plant supplies	69	750	750
g) Health Department Fees	700	700	700
h) EPA Monitoring	-0-	250	250
4. Accounting - Annual	-0-	400	400
5. Rate Case: \$2,000/3 Yr. Amortization	-0-	667	667
6. Taxes:			
a) Income	50	1,215	1,028 ⁽⁴⁾
b) Other	-0-	2,430	1,000 ⁽⁵⁾
7. Insurance	-0-	350	350
8. Miscellaneous	12	250	250
Total Expenses	\$ 6,787	\$ 43,271	\$ 28,971
Net Income	(\$ 5,017)	\$ 5,289	\$ 4,029

- (1) Test Year and Proforma Requested revenues and expenses were taken from the Utility's Comparative Income Statement for the twelve month period ending June 30, 1979.
- (2) The Utility failed to adequately substantiate the requested \$8,550 as its annual expense for routine operations and maintenance. An allowance of \$4,200 for this expense was considered by the Commission to be more reasonable.
- (3) The Utility failed to adequately substantiate its requested allowance of \$15,000 for annual electric costs. The Commission considers \$8,000 to be a more realistic allowance for this expense.
- (4) The corporate tax liability for the revenues that should be realized from the rates approved by this Order has been computed as \$1,028.
- (5) The Utility failed to adequately substantiate its requested allowance of \$2,430 for taxes other than income taxes. The Commission finds that \$1,000 is a more reasonable allowance for this expense.