COMMONWEALTH OF KENTUCKY

BEFORE THE UTILITY REGULATORY COMMISSION

* * * * *

In the Matter of:

AN ADJUSTMENT OF RATES OF B & H, INC.	))	CASE NO. 7550

O R D E R

Preface

On August 17, 1979, B & H, Inc., the Applicant, filed with this Commission its duly verified application seeking authority to increase its sewage service rates.

The case was set for hearing at the Commission's Offices in Frankfort, Kentucky, December 5, 1979. All parties of interest were notified and the Consumer Protection Division of the Attorney General's Office intervened 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 a final determination by this Commission.

Test Period

The Applicant has selected the twelve month period ending July 31, 1979, as the "Test Year" and has submitted a tabulation of its revenues and expenses for this period including the proforma adjustments thereto for the Commission's consideration in the determination of rate adjustments.

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's 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. Therefore, the Commission is of the opinion that for the purpose of establishing or fixing rates for sewage utilities, the operating ratio[1] method should be utilized although it is recognized that there may be instances where this method or procedure 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 the Applicant provides sewage service to the residences located within the Brocklyn Subdivision in Madison County, Kentucky.

2. That according to the record in this matter, the Applicant without the permission or approval of the Commission, on May 1, 1976 increased the charges for sewage service in the amount of $2.50 per single-family residence and established a new rate of $5.65 per unit for multi-family residences. Further, that these rates are illegal in that they are higher than the rates filed with this Commission at the time the Commission obtained jurisdiction over this utility under authority of KRS 278.010.

3. That the Applicant's annual proforma expenses are estimated by the Commission to be $14,695.

4. That the rates as prescribed and set forth in Appendix "A", attached hereto and made a part hereof should produce gross annual revenues of approximately $16,751 from 147 customers and are the fair, just, and reasonable rates to be charged for sewage services rendered by the Applicant to customers located in Brocklyn Subdivision, Madison County, Kentucky.

---

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

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

5. That an operating ratio of .877 results from test-year operations as adjusted and provides a reasonable return margin(2) in this instance.

6. That the rates proposed by the Applicant are unfair, unjust, and unreasonable in that they would produce revenues in excess of those found reasonable herein.

7. That the Applicant has filed with this Commission a valid third-party beneficiary agreement.

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 the investment of said facilities in the sale price of his lots or, as an alternative, to donate said 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.

---

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

9. That the Commission after considering the tabulation of test-year and projected revenues and expenses submitted by the Applicant concludes that said revenues, expenses and proforma adjustments can be summarized as shown in Appendix "C", attached hereto and made a part hereof. On the basis of this tabulation, the Commission further concludes that gross annual revenues in the amount of $16,751 are necessary and will permit the Applicant to meet its reasonable expenses for providing sewage disposal services to its customers.

10. That all monies collected from the Applicant's customers by the unauthorized rates subsequent to May, 1976 which exceeded the amounts that would have been collected on the basis of the Applicant's authorized rates should be refunded by the Applicant to the customers from which said excess monies were collected.

11. That the Applicant should provide a complete listing to this Commission of all customers to whom refunds are due and said listing should also include the amount of refund due to each affected customer.

12. That the Applicant should provide this Commission with a plan detailing how and when affected customers will be refunded.

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, are hereby fixed as the fair, just and reasonable rates of the Applicant to become effective for services rendered on and after the date of this Order.

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

IT IS FURTHER ORDERED that the Applicant shall refund to its customers all monies collected subsequent to May, 1976 which exceeded the amounts that would have been collected on the basis of rates filed with this Commission at the time the Commission obtained jurisdiction over this Utility under authority of KRS 278.010.

IT IS FURTHER ORDERED that the Applicant shall provide this Commission within thirty (30) days of the date of this Order, a listing of all customers who shall be refunded. Said listing shall also include the amount of refund due to each customer.

IT IS FURTHER ORDERED that the Applicant shall provide this Commission, within thirty (30) days of the date of this Order, a plan detailing how and when affected customers shall be refunded.

IT IS FURTHER ORDERED that the Applicant shall 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 copies of all the Applicant's rules and regulations for providing water service to customers located in the Brocklyn Subdivision, Madison County, Kentucky, shall be filed with the said tariff sheets.

Done at Frankfort, Kentucky, this 5th day of March, 1980.

UTILITY REGULATORY COMMISSION

CHAIRMAN

VICE-CHAIRMAN

COMMISSIONER

ATTEST:

SECRETARY

APPENDIX "A"

APPENDIX TO AN ORDER OF THE UTILITY REGULATORY COMMISSION IN CASE NO. 7550 DATED MARCH 5, 1980.

The following rates are prescribed for sewage disposal services for all customers that are located in Brocklyn Subdivision, Madison County, Kentucky and that are provided said service by B & H, Inc.

Type of Service Provided	Monthly Rate
Single-Family Residences	$10.65 Per Residence
Multi-Family Residences	8.00 Per Unit

APPENDIX "B"

APPENDIX TO AN ORDER OF THE UTILITY REGULATORY COMMISSION IN CASE NO. 7550 DATED MARCH 5, 1980.

A listing of cases and decisions that substantiate Finding Number 8.

(1) 28 U.S.C. § 362(c) (1976).
Dealing with the Basis to Corporations in Reorganization. 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 (rth Cir. 1964).
Taxpayers are not allowed to recoup, by means of depreciation 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 & 559, (Nev. Pub. Serv. Comm., May 14, 1970).
Where a general improvement district sought to increase 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" DATED MARCH 5, 1980.

In accordance with Finding No. 9, the following tabulation is the Commission's summary of the test year and projected annual revenues and expenses for the Applicant's sewage treatment facilities which serves approximately 147 customers located in Madison County, Kentucky.

	Test Year[1]	Proforma[1] Requested	Proforma Found Reasonable
(No. of Customers)	(147)	(147)	(147)
Revenues:			
1. Sewage Service Fees	$ 13,068	$ 17,292	$ 16,751
Total Revenues	$ 13,068	$ 17,292	$ 16,751
Expenses:			
1. Labor & Maintenance	$ 1,744	$ 1,744	$ 1,744
2. Electricity	2,738	2,738	2,738
3. Water	700	700	700
4. Legal			
a) Annual	321	321	321
b) Rate Case (3 year Amortization)	-0-	133	133
5. Insurance	20	20	20
6. Plant Supplies	1,343	1,343	1,343
7. License Fees	60	60	60
8. Office Supplies	106	219	219
9. Property Tax	65	65	65
10. Miscellaneous	32	32	32
11. Administrative Services	7,320	7,320	7,320
Total Expenses	$ 14,449	$ 14,695	$ 14.695
Net Income	[$ 1,381]	$ 2,597	$ 2,056

(1) "Test Year" and "Proforma Requested" revenues and expenses were taken from the Applicant's Comparative Income Statement for the twelve (12) month period ending July 31, 1979, the test-year in this matter.