

COMMONWEALTH OF KENTUCKY  
BEFORE THE UTILITY REGULATORY COMMISSION

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In the Matter of:

THE APPLICATION OF JOANN ESTATES )  
UTILITIES, INC., MCCRACKEN COUNTY, )  
KENTUCKY, FOR (1) AN ORDER ISSUING ) CASE NO. 7603  
A CERTIFICATE OF PUBLIC CONVENIENCE )  
AND NECESSITY AND (2) APPROVING A )  
NEW SCHEDULE OF RATES )

O R D E R

Preface

On October 15, 1979, Joann Estates Utilities, Inc., hereinafter referred to as the "Utility", filed with this Commission a duly verified application seeking a Certificate of Public Convenience and Necessity authorizing the construction of two (2) sewer collector main extensions to serve the anticipated residents of Joann Estates Subdivision, Phase II and Spring Brook Manor Subdivision in McCracken County, Kentucky. This application also seeks approval of an adjustment in rates for the Utility.

The case was set for hearing at the Commission's office in Frankfort, Kentucky, on February 21, 1980. All parties of interest were notified with the Consumer Protection Division of the Attorney General's Office permitted to intervene in the matter.

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

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 July 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 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, depreciation of the plant, the net investment, the capital structure, the cost of reproduction, and the going concern 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. There are numerous instances of title changing hands prior to the effective date of Commission jurisdiction (January 1, 1975). Further, the Commission has found that the books, records and accounts of many of these utilities are incomplete. In such instances, the fixing of rates on the above methods of valuation is impossible. The Commission is, therefore, of the opinion that the "Operating Ratio Method"<sup>(1)</sup> should be utilized in ratemaking determinations for sewage utilities although it is recognized that there may be instances where another method 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 requires the construction of two (2) sewer collector main extensions in Joann Estates Subdivision, Phase II and Spring Brook Manor Subdivision in McCracken County, Kentucky, as set forth in the Application.

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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. That from the record and exhibits filed in this matter, the Utility will finance the project cost of approximately \$134,616 utilizing private funds and plans to recover all associated construction and installation costs of the sewer collector main extensions through the sale of residential lots within Joann Estates Subdivision, Phase II, and Spring Brook Manor Subdivision, so long as the capacity limitation of the existing 25,000 gallon plant is not exceeded. Further, that the Commission should make no further findings regarding the proposed financing other than that development costs are to be recouped in the sale of lots and should not have any adverse effect on customers rates or the Utility's ability to provide service.

3. That a valid third party beneficiary agreement is on file with the Commission.

4. That the Utility should file with this Commission a duly verified document or documents (final invoices, etc.) which show the total costs for construction and all other capitalized costs (administrative, legal, engineering, etc.) within sixty (60) days of the date that construction is substantially completed.

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

6. That the rates prescribed and set forth in Appendix "A", attached hereto and made a part hereof, should produce annual revenues of approximately \$6,340 from 62 customers and are the fair, just, and reasonable rates to be charged for sewage services rendered by the Utility, in the Joann Estates Subdivision of McCracken County, Kentucky.

7. That an operating ratio of 0.91 results from the projected operations as adjusted and provides a reasonable return margin<sup>(2)</sup> 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 significance in past years. The value of contributed property in currently operating water and sewage utilities, however, is frequently

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

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.

9. 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 \$6,340 are necessary and will permit the Utility to meet its reasonable expenses for providing sewage collection and disposal service to 62 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 Joann Estates Utilities be and is hereby granted a Certificate of Convenience and Necessity to construct two (2) sewer collector main extensions to serve the anticipated residents of Joann Estates Subdivision, Phase II, and Spring Brook Manor Subdivision in McCracken County, Kentucky.

IT IS FURTHER ORDERED that the Utility shall file with this Commission a duly verified document or documents regarding the total costs for this project in accordance with Finding No. 5, as previously set forth herein.

IT IS FURTHER ORDERED 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 Joann Estates Subdivision, Phase II, and Spring Brook Manor Subdivision in McCracken County, Kentucky, to become effective for services rendered on and after the date of this Order.

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 service to its customers shall be filed with said tariff sheets.

Done at Frankfort, Kentucky, this 2nd day of July, 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. 7603 DATED JULY 2, 1980.

The following rates are prescribed for sewage disposal services rendered to all residential customers served by Joann Utilities, Incorporated, in Joann Estates Subdivision, in McCracken County, Kentucky:

<u>Type of Service Provided</u>	<u>Monthly Rate</u>
Single-Family Residential	\$ 8.50 per Residence
Multi-Family Residential	\$ 6.35 per Dwelling Unit

APPENDIX "B"

APPENDIX TO AN ORDER OF THE UTILITY REGULATORY  
COMMISSION IN CASE NO. 7603 DATED JULY 2, 1980.

A listing of cases and decisions that substantiate finding  
number 6.

- (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 be 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. 7603 DATED JULY 2, 1980.

In accordance with Finding No. 10, the following tabulation is the Commission summary of the "Test-Year" and projected annual revenues and expenses for the Utility's 25,000<sup>(1)</sup> GPD sewage collection and treatment system for providing service to test-year and proforma customers.

(No. of Customers)	Test Year(2) Per Books (36)	Proforma(2) Requested (62)	Proforma Found Reasonable (62)
<u>Revenues:</u>			
1. Income from Service	\$ 3,040	\$ 6,340	\$ 6,340
Total Revenues	\$ 3,040	\$ 6,340	\$ 6,340
<u>Expenses:</u>			
1. Sewage System Operations			
a) McCoy & McCoy	162	200	200
b) Florence-Hutcheson	38	-0-	-0-
c) Repair Parts	75	75	75
d) Maintenance Salaries	399	2,219	2,219
e) Utilities	1,157	1,157	1,157
f) Chemicals	184	184	184
2. Other Expenses			
a) Insurance	625	625	625
b) PSC Assessment-1978	50	-0-	-0-
c) Dept. of Revenue	50	50	50
d) Legal Fees	731	219	219
e) Accounting Fees	125	125	125
f) Engineering Fees	-0-	652	652
g) Property Tax	81	81	81
h) State Tax	179	179	179
Total Operating Expenses	\$ 3,856	\$ 5,766	\$ 5,766
Net Income (Loss)	(\$ 816)	\$ 574	\$ 574

(1) A 25,000 GPD treatment plant has a design capacity to provide service to 62.5 single-family residences.

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