

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE AMENDED APPLICATION OF ORCHARD)
GRASS SANITATION, INC., FOR AN)
ORDER PURSUANT TO CHAPTER 278 OF)
THE KENTUCKY REVISED STATUTES) CASE NO. 8193
AUTHORIZING AN ADJUSTMENT IN RATES)
FOR THE EXISTING SEWAGE TREATMENT)
PLANT SERVING ORCHARD GRASS HILLS)
SUBDIVISION, OLDHAM COUNTY, KENTUCKY)

ORDER ON REHEARING

On March 11, 1982, the Commission issued its Order granting a rehearing on two specific issues contested by Orchard Grass Sanitation, Inc., ("Orchard Grass") in its February 19, 1982, petition for rehearing in this matter. In the Order of March 11, 1982, the Commission found that a rehearing should be granted to allow the parties an opportunity to present additional evidence on the issue of depreciation and interest expense.

Prefiled testimony was submitted by Orchard Grass on these issues and a hearing was conducted on May 25, 1982, at the Commission's offices in Frankfort, Kentucky.

The Commission, in its Order in this matter of February 1, 1982, denied the amended application of Orchard Grass for authorization to issue an evidence of indebtedness to its parent, Titan Development Corporation ("Titan Development"). The debt

for which Orchard Grass requested Commission approval was to repay funds supplied by Titan Development for the purpose of constructing sewage treatment facilities and for cash operating deficits resulting from previous years of operation. In support of its decision to deny the authorization to issue evidence of indebtedness the Commission found that the original intent of Orchard Grass and Titan Development was to recover its investment in sewage treatment plant through the sale of lots, and that to approve the financing of prior years' operating losses and the recovery of those deficits from the current ratepayers would constitute retroactive rate-making.

The decision to deny the authorization to issue evidence of indebtedness resulted in the decision to deny any depreciation expense. This is supported by a sound policy of the Commission to deny depreciation expense on contributed property. Thus, if the Commission finds that Orchard Grass' and Titan Development's original intent was to recover its investment from individuals purchasing lots with sewer facilities included, and that through the sale of all land holdings by Titan Development, the cost of sewage treatment facilities has in fact been recovered, then it must conclude that the property is fully contributed and accordingly disallow any depreciation expense.

In its petition for rehearing, Orchard Grass argued that it has not recovered the cost of the treatment plant in lot sales, and that it has always treated the principal sum on which the interest expense has been computed as a loan and not as a capital

contribution, and that Titan Development has always treated the transaction as a loan.

The Commission has not taken issue with the recording of the funds in question as a payable to associated companies nor has it approved debt financing in any form for Orchard Grass. The issue at hand is the original intent of Orchard Grass with regard to the provision of sewage treatment facilities and the question of whether the customers, or Orchard Grass, would be obligated to pay for those facilities. In its Order of February 1, 1982, the Commission found based on the record in this matter that the intent of Orchard Grass and Titan Development was to charge the customers of Orchard Grass only for the operation and maintenance of the utility. As that Order pointed out the level of operating and maintenance expenses proposed by Orchard Grass contained no provision for interest on funds used for the construction of sewage treatment facilities. Moreover, Orchard Grass has never included in its expenses any interest on debt obligations and has never requested authority to borrow funds for any purpose until its amended application was filed in this case on July 27, 1981.

In this proceeding the Commission is of the opinion that the original intent with regard to financing of the sewage treatment facilities is of the utmost importance, inasmuch as the facts at the time the Commission authorized construction of the facilities were relied upon by the Commission in reaching its decision.

Orchard Grass has not offered any evidence through its prepared testimony or as a result of cross-examination which supports its contention that the original intent of Orchard Grass was to recover its capital from its customers. In fact the witness for Orchard Grass testified that he was not employed by Orchard Grass or its parent company at the time of the previous rate case and construction cases and could only speculate as to the intent of management at that time.

The implications of the decision on the issue of authorization to issue evidence of indebtedness are far greater than the instant case. Orchard Grass is not unique in its form of corporate organization or its means of acquiring capital for new construction as well as operations. Many similar situations exist within utilities under the purview of this Commission because of the very nature of the sewer utility industry.

The Commission, since January of 1975, when sewer utilities were placed under its jurisdiction, has recognized the unique ownership and operating characteristics of sewer utilities. In the instant case the parent corporation, Titan Group, Inc. ("Titan Group"), established separate subsidiaries to conduct land development and sewage disposal operations in the Orchard Grass Hills subdivision of Oldham County, Kentucky. As the Commission pointed out in Case No. 6683:

. . . 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."

When a separate entity is established, as in the case of Orchard Grass, to provide sewage treatment service the utility has no means of recovering its investment except through rates approved by this Commission or contributions from the developer. If the developer and sewer utilities were two separate entities with no corporate relationship the sewer utility would naturally require some form of payment by the developer for the privilege of connecting to the sewage facilities. In determining the feasibility of a sewer construction project the Commission must consider the rate that will be required to operate the sewer utility. If the utility for some reason establishes a rate which is artificially low, and does not cover its cost of service, a project which may appear to be feasible at one point in time may not be feasible because of excessive rates in the future. At the time the construction was certificated by this Commission for Orchard Grass, it represented to the Commission that the funds for constructing the sewage treatment facilities would be provided by the parent company and that no debt service would be required by the sewer utility. No evidence to the contrary has been presented in this case.

Summary of Findings

Based upon the evidence of record and being advised, the Commission hereby finds that:

1. Orchard Grass intended that its customers pay for only the operating and maintenance expenses of the sewage treatment plant.

2. Orchard Grass did not intend that its customers pay for the cost of constructing its sewage treatment facilities through rates.

3. Orchard Grass received advances from Titan Development for the cost of construction of sewage treatment facilities.

4. Orchard Grass and Titan Development intended to recoup the cost of constructing sewage treatment facilities through the sale of lots served by the facilities.

5. The original intent of Orchard Grass is of utmost importance because it was relied upon by the Commission as the basis for issuance of a Certificate of Convenience and Necessity to construct a sewage treatment plant in Case No. 6683.

6. Orchard Grass has not presented any evidence to justify a modification of the Commission's Order entered February 1, 1982.

IT IS THEREFORE ORDERED that the Commission's Order entered February 1, 1982, be and it hereby is affirmed in all respects.

Done at Frankfort, Kentucky, this 13th day of August, 1982.

PUBLIC SERVICE COMMISSION

Marlin M. Vohy
Chairman

Did not participate
Vice Chairman

Dennis Lawson
Commissioner

ATTEST:

Secretary