

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF KENTUCKY MOUNTAIN)
HOUSING DEVELOPMENT CORPORATION, INC.)
FOR A CERTIFICATE OF PUBLIC CONVENIENCE) CASE NO. 8822
AND NECESSITY TO CONSTRUCT SEWAGE)
FACILITIES AND FOR AUTHORITY TO)
ESTABLISH RATES)

O R D E R

Kentucky Mountain Housing Development Corporation, Inc., ("Kentucky Mountain") filed an application on April 21, 1983, for a certificate of public convenience and necessity authorizing the construction of a 15,000 gallon per day sewage treatment plant and collection system and approval of proposed initial rates.

A hearing was held on September 1, 1983, in the offices of the Public Service Commission in Frankfort, Kentucky. At the hearing certain requests for additional information were made. This information has been filed.

A copy of a letter from the Natural Resources and Environmental Protection Cabinet approving Kentucky Mountain's plans and specifications for the proposed project is on file with this Commission.

COMMENTARY

Kentucky Mountain is a non-profit development corporation, organized and existing under the laws of the

Commonwealth of Kentucky. The sewage system to be operated by Kentucky Mountain is expected to serve 37 customers in the Laurel Heights Subdivision located in Clay County, Kentucky.

TEST PERIOD

Kentucky Mountain is a proposed rather than an operating utility and, accordingly, no historical financial information exists to serve as a basis for a test period. Therefore, estimated pro forma operating expenses have been utilized in the determination of Kentucky Mountain's revenue requirements, and in the formulation of the rates to produce those revenues.

REVENUE AND EXPENSES

Kentucky Mountain provided the Commission with projections of the revenues to be realized and the expenses to be incurred as a result of its operation of the sewage system in the Laurel Heights Subdivision. The projected costs contained in the application were subsequently revised by Kentucky Mountain.¹ The Commission is of the opinion that the revised projected data is generally proper and acceptable for rate-making purposes with certain modifications as set forth below:

Depreciation Expense

As a result of issues that were addressed during the hearing of September 1, 1983, Kentucky Mountain revised its operating expenses. These revisions included an amount of

¹ Kentucky Mountain, filing of November 8, 1983.

\$285 which reflected the estimated depreciation expense associated with the collection system manholes, cleanouts and piping.

The information submitted in Kentucky Mountain's application indicated that total funding for the construction of the sewage system will be provided by grants from the Farmer's Home Administration ("FmHA") and the Appalachian Regional Commission ("ARC").² Due to the fact that the funding of this project is to be provided fully by grants, the Commission is of the opinion that all items of plant constructed with these funds constitute contributed property. Therefore, adhering to its established rate-making policy of disallowing depreciation expense associated with contributed property, the Commission has reduced Kentucky Mountain's projected operating expenses by \$285.

An examination of Kentucky Mountain's projections of annual depreciation revealed that the total cost of the various components of utility plant on which the depreciation expense was based differed from the total cost estimate of the sewage collection and treatment plant facilities to be installed. Kentucky Mountain stated that in formulating the cost of utility plant on which to base annual depreciation expense, the installation costs of the various items of plant had been excluded.³ Mr. Lee Richie of Nesbitt Engineering,

² Item F of application.

³ Response to Commission's Order dated July 5, 1983, Item Nos. 2 and 3.

project manager for Kentucky Mountain, related during the September 1, 1983, hearing that the installation costs were excluded due to the fact that the financing of the project was derived from grant funds.⁴

The Commission is of the opinion that this method of determining the cost of utility plant is inconsistent with its established policy that all components of utility plant be recorded on the utility's books of account at original cost. Moreover, the Commission finds that Kentucky Mountain, in establishing utility plant on its books of account, should adhere to the original cost format as set forth in the Uniform System of Accounts for Class C and D Sewer Utilities as prescribed by this Commission, and should, for the purposes of financial reporting, utilize the original cost basis in determining annual depreciation expense.

Based upon the revised estimates, Kentucky Mountain's total projected operating expenses amounted to \$5,265. Upon consideration of the effect of the Commission's adjustments as determined herein, the total amount of pro forma operating expenses found reasonable is \$4,980.

REVENUE REQUIREMENTS

Kentucky Mountain developed its proposed rates on the basis of generating revenues sufficient to pay its annual operating expenses. Based upon the rendering of sewer service to 37 customers, Kentucky Mountain originally

⁴ Transcript of Evidence, September 1, 1983, pp. 17-18.

proposed rates that would produce annual revenues in the amount of \$9,484. As a result of revisions to its projected operating expenses, Kentucky Mountain proposed revised rates that would produce annual revenues in the amount of \$5,316.

The Commission, having examined the evidence of record in this case, is of the opinion that the operating ratio⁵ is the acceptable method for determining the revenue requirements of Kentucky Mountain. Moreover, the Commission finds that the operating ratio of 94 percent, which is the operating ratio produced by the proposed revenue, will produce a reasonable level of revenue, and will provide sufficient coverage of Kentucky Mountain's projected operating expenses. The application of an operating ratio of 94 percent to Kentucky Mountain's allowable projected operating expenses results in a projected revenue requirement of \$5,316. Therefore, the Commission concludes that Kentucky Mountain should be allowed to establish rates that will produce total annual revenues in this amount.

OTHER ISSUES

Accounting Records

In submitting its projected revenues and expenses for the Commission's consideration in this proceeding, Kentucky Mountain did not present its financial exhibit in accordance with the Uniform System of Accounts. The Commission is aware of Kentucky Mountain's unfamiliarity with this system of

⁵ Operating Ratio = $\frac{\text{Operating Expenses}}{\text{Gross Revenue}}$

financial reporting, and has, therefore, for the purpose of determining initial rates in this case, accepted the financial data in the format presented in this application. However, the Commission gives notice that for consideration in any future proceedings, Kentucky Mountain shall maintain its books of accounts and shall report its results of operations in accordance with the format established in the Uniform System of Accounts for Class C and D Sewer Utilities as prescribed by this Commission.

Subsidization

According to the information submitted in the application, of the 37 homes to be constructed in the Laurel Heights Subdivision, Kentucky Mountain anticipates 7 homes to be occupied by the end of the first year of operations and 22 homes by the end of the second year, with full occupancy of the subdivision to be realized during the third year of operations. Kentucky Mountain also indicated that until the subdivision is fully occupied it will absorb any operating expenses that the system may incur in excess of its operating revenues.⁶ In addition, Kentucky Mountain submitted a valid third-party beneficiary agreement, whereby, in the event of the dissolution of Kentucky Mountain, Red Bird Mission, Inc., will become the successor corporation, and will assume responsibility for the operation of the sewage treatment system. The Commission is of the opinion that subsidization

⁶ Response to Commission's Order dated May 31, 1983, Item No. 5.

by Kentucky Mountain of any revenue shortfall will be necessary to insure adequate operation of the system until such time as it becomes self-supporting.

RATE DESIGN

In its application Kentucky Mountain proposed declining rates based on each customer's water usage. Kentucky Mountain estimated that each customer's usage would average 4,600 gallons per month. In an information request the Commission asked that Kentucky Mountain provide an alternative flat rate schedule. In a response received June 14, 1983, Kentucky Mountain proposed a flat rate of \$16.50 per month for a 2 bedroom house, \$21.25 per month for a 3 bedroom house and \$26.00 per month for a 4 bedroom house. On July 25, 1983, Kentucky Mountain reduced its proposed rates to \$10.75, \$15.50 and \$20.00, respectively, due to the reduction in administrative costs if a flat rate is utilized. On November 8, 1983, Kentucky Mountain filed revised rates of \$8.00, \$12.00 and \$15.00, respectively, due to a decrease in estimated operating costs. The Commission is of the opinion that since Kentucky Mountain estimated that all customers would use approximately the same amount of water per month there is no justification for three separate rates, and, therefore, one flat rate should be granted in this case.

Should Kentucky Mountain desire to establish rates based on the number of bedrooms contained in each household in any future rate case, it must provide justification that usage does increase for each additional bedroom.

FINDINGS AND ORDERS

Based on the evidence of record, the Commission is of the opinion and finds that:

1. Public convenience and necessity require that the construction proposed in the application be performed and that a certificate of public convenience and necessity be granted.

2. The construction project proposed by Kentucky Mountain consists of a sewage collection system and a 15,000 gallon per day sewage treatment plant to provide sewage service for a proposed subdivision consisting of 37 single-family residential units.

3. The total cost of the sewage facilities is estimated to be \$114,209 of which \$112,009 will be provided by FmHA and ARC grants. The administrative costs which are estimated to be \$2,200 will be recouped by Kentucky Mountain at such time as all 37 lots of the proposed development have been sold.

4. The rate in Appendix A is the fair, just and reasonable rate to be charged by Kentucky Mountain as it will produce gross operating revenues of \$5,316 annually after full development of the 37-lot subdivision.

5. The rates proposed by Kentucky Mountain should be denied.

6. Kentucky Mountain did not present its projected financial information in accordance with the format

established in the Uniform System of Accounts for Class C and D Sewer Utilities as prescribed by this Commission.

7. Kentucky Mountain represented to the Commission that it will subsidize any shortfall of operating revenue until such time as the sewage treatment system becomes self-supporting. The granting of a certificate of public convenience and necessity and approval of the rates herein are expressly conditioned on the performance of this undertaking by Kentucky Mountain.

8. Kentucky Mountain has filed with the Public Service Commission a valid third-party beneficiary agreement as a part of its application.

9. Kentucky Mountain should furnish duly verified documentation of the total cost of this project including the cost of construction and all other capitalized costs (engineering, legal, administrative, etc.) within 60 days of the date that construction is substantially completed.

10. Kentucky Mountain should furnish to the Commission a copy of the "as-built" drawings and a signed statement that the construction has been satisfactorily completed in accordance with the contract plans and specifications within 60 days of the date of substantial completion of this construction.

IT IS THEREFORE ORDERED that Kentucky Mountain be and it hereby is granted a certificate of public convenience and necessity to proceed with the construction of the sewage

treatment and collection system described in the application and record.

IT IS FURTHER ORDERED that Kentucky Mountain be and it hereby is granted a certificate of public convenience and necessity to operate this sewer system.

IT IS FURTHER ORDERED that the rate in Appendix A be and it hereby is fixed as the fair, just and reasonable rate to be charged by Kentucky Mountain for sewer service rendered on and after the date of this Order.

IT IS FURTHER ORDERED that the rates proposed by Kentucky Mountain be and they hereby are denied.

IT IS FURTHER ORDERED that Kentucky Mountain be and it hereby is directed to abide by the conditions in Finding No. 7.

IT IS FURTHER ORDERED that Kentucky Mountain shall maintain its books of account and shall report its results of operations in accordance with the format established in the Uniform System of Accounts for Class C and D Sewer Utilities as prescribed by this Commission.

IT IS FURTHER ORDERED that Kentucky Mountain shall file its tariff sheets setting forth the rate approved herein within 20 days of the date of this Order.

IT IS FURTHER ORDERED that Kentucky Mountain shall file with the Commission duly verified documentation which shows the total costs of the construction herein certificated

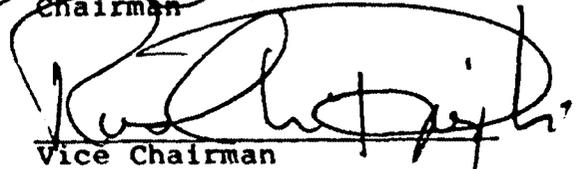
including all capitalized costs (engineering, legal, administrative, etc.) within 60 days of the date that construction is substantially completed.

IT IS FURTHER ORDERED that Kentucky Mountain shall furnish this Commission with "as built" drawings and a signed statement that the construction has been satisfactorily completed and has been done in accordance with the contract plans and specifications within 60 days of the date of substantial completion of the proposed construction.

Done at Frankfort, Kentucky, this 24th day of February, 1984.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary

APPENDIX A

**APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION IN CASE NO. 8822 DATED February 24, 1984.**

The following rate is prescribed for the customers in the area served by Kentucky Mountain Housing Development Corporation, Inc., located in Clay County, Kentucky.

Rate: Monthly

Single Family Residential

\$ 11.98