

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

INVESTIGATION INTO THE CUSTOMER DEPOSIT)	CASE NO.
POLICY OF KENTUCKY POWER COMPANY)	89-057

O R D E R

The Commission opened this case upon its own motion. The question presented in this matter is whether KRS 278.460,¹ and the case law interpreting it, requires utilities to compound interest they are required to pay on amounts deposited with them by their customers. Secondly, should the Commission give retroactive effect if it determines that KRS 278.460 requires utilities to compound interest. On April 18, 1989, the Commission held a hearing on this matter. Additionally, briefs from Kentucky Power Company ("Kentucky Power"), Cincinnati Bell Telephone Company

¹ KRS 278.460 states: "[p]ublic utilities, such as gas, electric and water companies, shall pay interest at six percent (6%) annually on amounts required to be deposited by patrons to secure gas, electric or water accounts." The predecessor statute of KRS 278.460 reads as follows:

"§1. That public utilities, such as gas, electric and water companies shall be required to pay holders of certificates of deposits six (6) per cent annually on amounts exacted from patrons for gas, electric and water accounts.

§2. Failure to comply with the above section shall subject the Utility Company violating said provision to indictment and prosecution and upon conviction to a fine of not less than One Hundred (\$100.00) Dollars for each offense." (Ky.St.Supp. 1933, §§2223-1, 2223-2)

("CBT"), Kentucky Utilities Company ("KU"), and Western Kentucky Gas ("WKG"), as well as the Attorney General ("AG") have been filed. The Commission has considered the briefs filed by the parties, as well as evidence presented at the hearing.

The legal question before the Commission pivots on the interpretation of the Kentucky decision, Commonwealth v. Kentucky Power and Light Co., Ky., 77 S.W.2d 395 (1934). Each party to this proceeding recognizes this case as the leading case which needs to be interpreted by the Commission. The two opposing positions taken in this matter cite this case for their respective positions. Kentucky Power, CBT, KU, and WKG argue that Kentucky Power and Light, analogizes the customer deposit to a demand note. They also take the position that an examination of the common law rules on interest rates for demand loans confirms the holding in Kentucky Power and Light, that simple interest is the proper calculation method. They cite Green Wade v. Williams, Ky., 281 S.W.2d 707 (1955) for the proposition that compound interest must be paid prior to a note's maturity and simple interest must be paid after the note's maturity. They then argue that under Kentucky law, a demand note matures on the date of its execution as that is the day a cause of action accrues and the statute of limitation commences with respect to the note. Gould v. Bank of Independence, Ky., 94 S.W.2d 991 (1936). They finally argue that because a customer deposit is likened to a demand note in the Kentucky Power and Light, only simple interest is required on utility deposits required by KRS 278.460. On the other hand, the AG argues Kentucky Power and Light, stands for the proposition

that interest on utility deposits is due annually and continues to run absent a customer demand for return on the deposit. The AG further argues that McWilliams v. Northwestern Mutual Life Insurance Company, Ky., 147 S.W.2d 79 (1941) read in conjunction with Kentucky Power and Light, stands for the proposition that utilities are required, upon customer demand, to pay interest annually, but absent such demand, the annual interest due and unpaid becomes an independent interest-bearing debt, thus concluding that KRS 278.460 requires compound interest.

After consideration, the Commission interprets Kentucky Power and Light, to hold that KRS 278.460 modifies the common law rule regarding demand notes and requires interest on deposits to be due annually which continues to run absent a customer demand for return of the deposit. The Court in Kentucky Power and Light, held:

At common law the rule is that. . . interest is due and payable at the time the principal is due. In the case of a demand loan, since the loan is not due until demand is made for it, it follows that in the absence of any statute to the contrary the interest . . . would not be due until demand for the return of the deposit be made. (Emphasis added)

Id. at 396. The Court then proceeded to recognize that this common law rule has been statutorily modified. While customer deposits are demand loans,

[T]he purpose of the act of 1932 [predecessor of KRS 278.460] was to give the customer the right to get his interest from time to time by way of payment or credit on his bill. . . .

The Legislature intended that the customer could continue as a customer, leaving his deposit with the company, but at the same time should have the right to obtain his interest at the end of each year if he desired it.

Id. at 396. The Court further held "[i]n the absence of such demand, the interest continues to run." Id. at 397. The Commission is of the opinion, therefore, that the enactment of KRS 278.460 has thus modified the common law rule to require interest on customer deposits to be due annually, rather than at the time of demand for return of the deposit.

This decision in Kentucky Power and Light, read in conjunction with McWilliams v. Northwestern Mutual Life Insurance Company, Ky., 147 S.W.2d 79, 81 (1941), indicates that utilities are required, upon customer demand, to pay interest annually, but absent such demand, the annual interest due and unpaid becomes an independent interest-bearing debt. The Court in McWilliams held, in the case of an insurance company's loan under a life policy, that:

It has long been the law in this jurisdiction that where a note expresses the date interest is to be paid and if the interest is not paid when it matures, then such interest becomes an independent debt and itself bears interest until paid.

This reasoning is in accord with that in Hall v. Scott's Adm'r., Ky., 13 S.W. 249 (1890),

It is true that interest runs on an interest-bearing debt, after its maturity, as a matter of legal right; and the same principle applies to interest on installments of interest after their maturity.

Id. at 250.

OAG 83-224 concurs with the above interpretation of the law:

[I]n the event that this annual interest is not remitted to the customer, and assuming the deposit is kept longer than one year, each yearly accrual of interest would become the property of the customer, in addition to the deposit, and a requirement would arise that interest accrue to that new debt as well as to the deposit itself.

The utilities additionally argue in their briefs that only simple interest was in fact paid on the customer's deposit in Kentucky Power and Light, despite the fact that the utility had held the customer's deposit for over two years and the customer had not been paid the interest which had accrued to the deposit at the end of each year. The above fact is true and is unexplainable. It, however, does not lead to the conclusion that the Court concluded that simple interest was permissible as the utilities argue. The payment of simple interest is in direct conflict with the above-stated holding of the court. It is also in conflict with the other well-recognized authority cited herein. The Court was totally silent regarding the correctness of the computation of interest actually paid to the complainant. Finally, as the AG points out, the facts were stipulated and therefore the Court never considered the correctness of the amount paid.

The Commission believes that the correct method of computing interest for customer deposits is explained in McWilliams. The Court in McWilliams, 147 S.W.2d at 82, explains the law relating to the methods of compounding interest. Absent a specific agreement, the unpaid interest may not be compounded by adding it to the original debt so it may draw interest on interest at every interest paying period. Since there is no specific agreement between the utility and the customer, the proper method of computing interest is what is described by the Court in McWilliams as "a middle course between simple and compound interest."

[T]he accrued interest is not combined with the principal but each installment of interest on the

principal becomes itself a new principal which bears simple interest, but no interest is allowed upon the interest on the interest; and although this method is also sometimes called compound interest, it has been more correctly described as a middle course between simple and compound interest.

Id. at 82.

Therefore, the Commission is of the opinion that the correct interpretation of KRS 278.460 is that interest on utility deposits should be calculated at no less than what is described in McWilliams, 147 S.W.2d at 82 as "a middle course between simple and compound interest." For administrative purposes utilities may want to pay compound interest which would simplify the necessary calculations. Of course, if annual interest payments (or credits) are made to customers with held deposits no calculation need be made.

The final issue to be decided is whether the Commission should give retroactive effect to its decision herein. The Commission is of the opinion that the law in Kentucky could have been subject to different interpretation in the past, arguably even by this Commission. Therefore, this decision shall be given prospective effect.

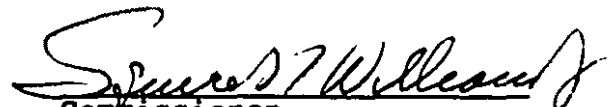
Being sufficiently advised, IT IS THEREFORE ORDERED that all utilities shall, from the date of this Order forward, calculate interest on deposits being held pursuant to KRS 278.460 at no less than what is described in McWilliams, as "a middle course between simple and compound interest." IT IS FURTHER ORDERED that all utilities with tariffs in conflict with the holding herein shall

file tariffs in conformity with this decision no later than 30 days of the date of this Order.

Done at Frankfort, Kentucky, this 31st day of October, 1989.

PUBLIC SERVICE COMMISSION


Vice Chairman


Commissioner

Dissenting Opinion of Chairman George Edward Overbey, Jr.

The Commission unanimously holds "that the correct interpretation of KRS 278.460 is that interest on utility deposits should be calculated at no less than what is described in McWilliams, 147 S.W.2d at 82 as a middle course between simple and compound interest."

The judgment that that decision is to be given prospective effect from the date of this order forward is one in which I must respectfully dissent.


As Justice Oliver Wendell Holmes said in Lochner v. N.Y., 198 U.S. 45, 76 (1905) "general propositions do not decide concrete cases."

The general and speculative notion that supports the Commission's call on this point is rationale, I submit, upon a jello foundation. Certainly such rationale ought not to be decisive of the concrete case issue of whether retroactive or prospective treatment should be accorded our decision.

Having correctly declared that a form of compound interest is the father, the Commission nonetheless concludes that the father's obligation to nourish its offspring commences only upon the date of the declaration or discovery of parenthood, not upon the offspring's birth.

It either "tis or taint"! Our decision is that Kentucky Power and Light Co., supra read in conjunction with McWilliams, supra is controlling. Kentucky Power was the law of Kentucky as of 1934, and we inferentially decree remained the law ever since.

That being literally the case, our decision should be given retroactive effect.


George Edward Overbey, Jr.
Chairman
Kentucky Public Service Commission

ATTEST:


Executive Director, Acting