

BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI

CASE NO. SO-88-140

In the matter of a tariff filing by  
West Elm Place Corporation regarding  
the calculation of taxes on connection  
fees and contributions in aid of  
construction.

---

APPEARANCES: Gary W. Duffy, Attorney at Law, Hawkins, Brydon,  
Swearengen & England, P.C., P. O. Box 456,  
Jefferson City, Missouri 65102, for West Elm Place  
Corporation.

Douglas M. Brooks, Public Counsel, P. O. Box 7800,  
Jefferson City, Missouri 65102, for the Office of  
the Public Counsel and the Public.

William K. Haas, Assistant General Counsel,  
P. O. Box 360, Jefferson City, Missouri 65102,  
for the Staff of the Missouri Public Service  
Commission.

REPORT AND ORDER

On November 12, 1987, West Elm Place Corporation (Company) filed proposed tariffs with this Commission designed to change the manner of calculation of connection fees and contributions in aid of construction so as to include the applicable income tax consequence.

By orders dated December 9, 1987 and April 5, 1988, the tariffs were suspended to October 5, 1988.

At the prehearing conference and hearing held on August 1, 1988, the Company and the Commission Staff read into the record the areas of agreement. Both Company and Staff have filed briefs and reply briefs, the record being closed with the filing of reply briefs on August 22, 1988.

### Findings of Fact

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact:

The Company is a sewer utility subject to the jurisdiction and regulation of this Commission. It provides sewer service to approximately 2,000 acres in northern Jefferson County and as of the end of 1987 served approximately 2,500 customers.

For a number of years the Company's tariffs have required contributions in aid of construction (CIAC) both in the form of plant and cash. As a condition of receiving service builders or developers build the sewer extensions and donate the new facilities to the utility in return for the utility's perpetual upkeep and operation. These contributions will be referred to in this Report and Order as Property CIAC.

In addition, the Company's tariff provides for a payment of an amount of money which will be referred to in this Report and Order as Cash CIAC. The amount of cash payment required by the Company's tariff for a single family dwelling is \$400.

As a result of changes in the Federal income tax laws by the Tax Reform Act of 1986, the contributions of plant and cash, which were previously not taxable income to the utility, have now become so. By filing the tariffs herein involved, the Company proposes to have those making the contributions bear the additional expense of the income tax due as a result of the contributions.

During the hearing both the Staff and the Public Counsel supported the concept of having the contributors pay an additional amount representing the income tax consequence on the contributions in the form of Property CIAC. In return, the Company agreed to modify its tariffs to provide for a refund to each individual contributor of any amount in excess of the income tax liability actually established by the Company's income tax return for the year that the contribution was made.

Proposed tariffs, reflecting the agreement concerning the tax consequences of Property CIAC, should be filed for Commission approval as hereinafter ordered.

The provision in the Company's tariff requiring a Cash CIAC was changed in 1981 so that the title for the charge under discussion was changed from "connection fee" to "contribution in aid of construction". Company attached a new proposed tariff to its brief in which the Cash CIAC under discussion has been named "construction contribution".

Regardless of its name, the requirements of a cash contribution is a widely accepted practice since those contributions are a major source of revenue for the funding of a sewer utility's construction program. The cash contributions have consistently been required to offset the average sewer company's difficulty in engaging in debt financing because of the small earning potential of sewer properties. Generally, since the Company's property or the funds that paid for the property were donated, the Company is not allowed to recover the investment by depreciation or earn a return on it. As in the case of its tariff concerning Property CIAC Company's Cash CIAC tariff is proposed to be amended to increase the \$400 charge for a single family dwelling by an amount corresponding to the income tax liability. The Commission Staff not only opposes the increase in the Cash CIAC but proposes an elimination of the entire Cash CIAC. The Public Counsel supported the Company's filed tariffs and did not take a position on the elimination of the Cash CIAC.

During early discussions in this matter, Staff asked the Company to calculate the amount of its plant additions for the years 1988 through 1991. The Company estimates that its plant additions will be \$174,923, \$278,449, \$295,086 and \$299,535 for the four years assuming the additions will be by the use of Company personnel. The Staff used the Company's actual historical data for the 1983 test year used in the Company's last rate case and the Company's construction estimates through calendar 1991 to determine that the Company's present rates would support a much larger rate base.

In the event it should be necessary to employ outside contractors, the Company's estimates of its total rate base for the same four years become \$208,470, \$360,453, \$406,022 and \$462,878. The Company criticizes the Staff's use of the lower cost for rate base additions. The Staff employed the lower figures because the evidence establishes that through 1987 use of outside contractors was unnecessary and it is also believed that outside contractors were not used in 1988 up to the time of the hearing.

According to the Staff's projection the Company's rate base can only be supported by equity in the approximate amount of ten percent by 1991. Some of the Staff members advocate an equity rate base of 20 to 30 percent and expressed the opinion that the Company's current rates would support a Company-supplied rate base of approximately an additional \$600,000, approximately triple the Company's estimates of its rate base assuming additions performed by Company personnel. Company supplied two estimates since its witnesses had no idea that far into the future whether the additional construction would be performed by all Company personnel or all outside contractors. Company's president is of the opinion that the real expenditures will be some place between the two extremes, but no more precise estimate can be performed. In the Commission's opinion the Staff's projections of the additions being constructed completely by Company personnel more than three years in the future is too speculative to be adopted.

In considering the Report and Order in the Company's last rate Case, SR-84-225, we are aware that the case was disposed of by stipulation wherein no finding was made as to rate base, reasonable level of expenses, or rate of return. The rate of return alluded to has been derived purely after the fact and the Company's rate base additions are too speculative to be the foundation of a decision.

According to the testimony of the Company's president, the rate base projections were based on the assumption that Cash CIAC would continue. In the absence of the receipt of Cash CIAC the Company's estimates were invalid. The

Company employs its Cash CIAC for the purpose of expanding sewer mains into remote portions of its service area to make possible its goal of extending sewer service to those potential customers that would not otherwise request service because of the prohibitive costs. It is the Company's desire to put as many customers on their sewer system as possible in order to eliminate septic tanks, improperly functioning lagoon systems, and other forms of pollution currently existing in the watershed.

In the Commission's opinion the Company's Cash CIAC is being employed for a laudable purpose and the evidence in the instant record is inadequate to show that the Company's use is unreasonable or unlawful.

In the Commission's opinion the Company should not experience a windfall from the developers or from the customers through the tax consequences of property or cash contributions. The Commission recognizes that the Company will pay the income tax on property contributions in the year in which the contribution is made. The Commission also recognizes that the Company will recover income taxes over the depreciable tax life of the property contribution. The Company will depreciate, over the tax life, the value of the contributed property and therefore will see an inflow or a return to the Company of those tax dollars which have been paid out in the year in which the property was contributed. With this additional cash from the return of the tax dollars and with the continuing cash contribution of \$400.00, the Commission finds that the Company will have the cash available for its continuing expansion of sewer mains into remote portions of its service area. Therefore, the Commission finds that it is unnecessary to gross up, for income tax purposes, the cash contribution. The Commission recognizes that the cash contribution has been a long-standing practice of this Company and therefore, at this time, will not eliminate the cash contribution.

We are of the opinion that the instant record is inadequate to establish the ability of the Company to finance its construction program by either borrowed funds or the infusion of new capital by the principals.

In the Commission's opinion the record is inadequate to establish that it is in the customers' interest for the Company to increase its rate base supported by either equity or borrowed funds by an amount of \$600,000 over such a short period of time.

The Commission is of the opinion that the proposed CIAC tariff, as amended by the Company at the time of hearing, should be approved.

#### Conclusions

The Missouri Public Service Commission has arrived at the following conclusions:

The Commission has jurisdiction over all rates and charges by sewer utilities pursuant to Chapters 386 and 393, RSMo 1986. The tariffs here under consideration were suspended pursuant to Section 393.150, RSMo 1986.

In the instant case the Company has proposed to amend its tariffs to include the taxes applicable to contributions by developers or other customers. In Cases No. WO-86-100 and WO-86-122, we determined that it was reasonable to require developers and other customers who contribute property to a utility to pay an additional amount equal to the taxes owed on those contributions. We determined in that case that similar treatment of all water utilities and was appropriate and reached a decision which the Commission believed to be applicable to all regulated water and sewer utilities unless it is determined that the rule does not apply in a separate case. In the instant case we are of the opinion that the record is inadequate to show the reasonableness of a departure from the general rule.

In addition, the instant case involves a proposal to disallow an existing long-term charge. In the Commission's opinion the theoretical reason for the disallowance is inadequate to be the basis of a determination that an existing charge is unreasonable.

For all of the foregoing reasons, the tariffs herein suspended should be disallowed and the Company should file, for Commission approval, tariffs consistent with this Report and Order.

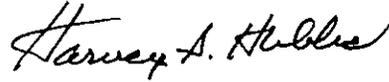
It is, therefore,

ORDERED: 1. That the tariffs herein suspended are hereby disallowed.

ORDERED: 2. That West Elm Place Corporation shall file permanent tariffs in compliance with the terms and conditions of this Report and Order.

ORDERED: 3. That this Report and Order shall become effective on the 24th day of October, 1988.

BY THE COMMISSION



Harvey G. Hubbs  
Secretary

(S E A L)

Steinmeier, Chm., Musgrave, Mueller,  
Hendren and Fischer, CC., Concur and  
certify compliance with the provisions  
of Section 536.080, RSMo 1986.

Dated at Jefferson City, Missouri,  
this 4th day of October, 1988.