BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

CASE NO. SA-79-11

In the matter of the approval of Stoddard County Sewer Co., Inc., for permission, approval, and a certificate of convenience and necessity authorizing it to construct, install, own, operate, control, manage and maintain a sewer system for the public located in an unincorporated area in Stoddard County, Missouri.

A certificate of convenience and necessity will be granted when the Commission finds that there is a public need for sewer service.

APPEARANCES: WILLIAM F. RINGER, Attorney at Law, 21 Vine Street, Dexter, Missouri 63841, for Applicant, Stoddard County Sewer Co., Inc.

DANIEL S. OCHSTEIN, Assistant Public Counsel, Office of the Public Counsel, Post Office Box 1216, Jefferson City, Missouri 65102, for the public.

L. RUSSELL MITTEN, II, and GARY W. DUFFY, Assistants General Counsel, Missouri Public Service Commission, Post Office Box 360, Jefferson City, Missouri 65102, for the staff of the Missouri Public Service Commission.

REPORT AND ORDER

By application filed on July 17, 1978, Stoddard County Sewer Co., Inc., seeks a certificate of convenience and necessity and permission to install, own, acquire, construct, operate, control, manage and maintain a sewer system for the public in an unincorporated area in Stoddard County, Missouri. A public hearing was held on October 19, 1978, at Dexter, Stoddard County, Missouri, for the purpose of receiving testimony and comments of homeowners in the proposed service area. Testimony of the Applicant was also taken at that hearing, which was subsequently continued to March 21, 1979, to complete examination of the company and staff witnesses. The continued hearing was held in the Commission's hearing room on the tenth floor of the Jefferson State Office Building as scheduled. Briefs were ordered and the reading of the transcript was not waived.

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.

Stoddard County Sewer Co., Inc., is a Missouri corporation with its principal office and place of business at Highway 114 West, Dexter, Missouri 63841. The Applicant proposes to construct and operate a combination gravity and pressure sewer system in Ecology Acres and Western Heights subdivisions near Dexter, in

Stoddard County, Missouri. There are 278 lots platted for both subdivisions and approximately 78 homes have been constructed. It is estimated that up to 270 homes will ultimately occupy these two subdivisions. Most of the existing homes are on individual septic tanks, while a few employ aeration systems. The existing septic tanks are unacceptable to the Missouri Department of Natural Resources because of the existing soil conditions, which preclude percolation of the effluent. The homes in these two subdivisions are relatively close to each other and when the effluent cannot drain into the soil, it tends to run on the surface across the yards. In order to bring the subdivisions into compliance with the environmental law and the regulations of the Missouri Department of Natural Resources, Carl Bien, the residential developer and the president of Stoddard County Sewer Co., Inc., hired an engineering firm, C. R. Trotter & Associates, to conduct an engineering and feasibility study for the sewer system. There are no public sewer districts or public utilities presently providing sewer service in the area sought. The Missouri Clean Water Commission, Department of Natural Resources, on December 22, 1978, issued a construction permit for the proposed sewer system. The Applicant plans to provide an employee for the daily operation and maintenance of the sewer system, and either the employee or some telephone number will be available for patrons to report any sewer problems.

The engineering feasibility study prepared by C. R. Trotter & Associates was received into evidence, and said study proposed two alternative methods for recovering the Applicant's investment over a ten year period. One method proposed would have imposed a connection charge of $1,100 and a monthly user fee of $13.33. The alternate method would have dispensed with the connecting charge and would have imposed a monthly user charge of $24.91.

The Applicant and the staff of the Missouri Public Service Commission entered into an oral stipulation and agreement whereby the sewer corporation would furnish 20 percent of the capital required for construction of the collecting sewer system to serve all 278 lots and 20 percent of the cost of the treatment plant and pump facilities designed to serve the first 105 lot owners to request service. A second treatment plant will be necessary when more than 105 customers request service. Ninety lots had been sold at the time of the hearing. A total of 78 houses have been constructed at both subdivisions. The Public Counsel of the State of Missouri did not enter into the stipulation and agreement, which calls f[illegible] connection fee of $1,035 and a monthly user rate of $11.40. The stipulated monthly

user rate would cover only estimated operation and maintenance expenses and is not designed to provide any return on rate base investment.

The total projected cost of construction is $174,000, of which $34,800 would be capitalized by the sewer corporation, and the remainder of $139,200 would be furnished through connection fees. One Hundred Eight Thousand Six Hundred Seventy-five Dollars ($108,675) would be furnished by the connection fees to be paid by the first 105 customers to request service. The stipulation and agreement would provide the first 105 customers up to twelve months in which to connect to the system at the stipulated fee of $1,035. After twelve months, a homeowner requesting service would be liable for an "interest" payment of twelve percent, or $100, on his pro rata contribution of $835 to the connecting sewers and treatment plant. The customer's estimated cost of installation for his service lines is $200, or the difference between $1,035 and $835. It is not planned that the twelve percent interest payment be applied to the cost of service lines, as the company would not incur that expense until such time as the customer comes onto the system. Customers coming on the system after the first 105 would then pay a connection fee based on their proportionate share of the collecting sewer construction costs and their share of the treatment plant that would then be built to serve them.

Ecology Acres was originally platted and subdivided by Emerson and Naomi Tucker, who recorded with the Recorder of Deeds of Stoddard County a restrictive covenant which provided, inter alia, the following: "There shall be no cost to the lot owner in connecting to the central sewage disposal system, but each lot owner agrees to pay the monthly service charge for use of said system as determined by the owner of said system and approved by the Missouri Public Service Commission or other regulatory agency having jurisdiction." The Tuckers sold the property in 1974 to Mr. Bien and Mr. Van Gibbs who, in turn, transferred it to Bien & Gibbs Lumber Company in 1975 or 1976. The restrictive covenant referred to above was excluded but introduced into the record by way of an offer of proof.

At the public hearing held in Dexter, conflicting testimony was received from witnesses who are residents of Ecology Acres concerning alleged representations made to them when they purchased their lots. Some testified that Mr. Bien told them that sewers would be furnished at no cost to them and that they were led to believe that sewers were included in their purchase price. One witness testified that Mr. Bien told him it would cost his approximately $1,000 to hook on when sewers were installed. One witness testified that Mr. Bien said nothing about sewers and that

he did not think that the price of sewers was included in his purchase price. Still others testified that they purchased their lots from Jim Lincoln or Paul Douglas, who purchased 50 lots from Bien & Gibbs Lumber Company, and were told by either Mr. Lincoln or Mr. Douglas that sewers were included in the purchase price.

Conclusions

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

The first issue to be addressed is that of the restrictive covenant. The Commission staff, in its brief, contends that the connection fee should be approved and that it would supersede any contractual provision in a restrictive covenant. The staff cites for authority Kansas City Power and Light Co. v. Midland Realty Co., 93 S.W.2d 954, 958 (Mo. 1936) where the Supreme Court stated:

> "It seems to be well settled by our decisions that the commission has the power to fix by order reasonable telephone, light, power and heating charges at rates exceeding the maximum prescribed by ordinance, franchise, or individual contracts, that such an order does not in the constitutional sense impair the obligations of such contracts, and that such rates automatically supersede all rates coming into conflict therewith."

and Kansas City Bolt and Nut Co. v. Kansas City Light and Power Co., 204 S.W. 1074 (Mo. banc 1918) where the Supreme Court said:

> "(1) That the power to make rates for public service arises from the police power of the state; (2) that the instrumentality designated by statute to exercise such ratemaking power is the Public Service Commission; (3) that under the provision of Art. 12, Sec. 5, Constitution of Missouri, the police power cannot be abridged by contract; (4) that therefore, when the Public Service Commission fixes a schedule of reasonable rates for public service in conformity with the provisions of the Public Service Commission Act, such rates automatically supersede all contract rates coming in conflict therewith." (204 S.W. at 1075.)

The staff's position is that by approving the stipulated connection fee, the Commission is not determining who is ultimately responsible for paying it and contends that the proper forum is circuit court in a case to determine if the successors in interest to the Tuckers are bound by the terms of the restrictive covenant that connection will be provided to a central sewer system at no cost to the customer. Staff states that the Commission cannot decide that question, citing Katz Drug Co. v. Kansas City Power and Light Co., 303 S.W.2d 672 (Mo. App. 1957).

The Public Counsel counters that the cases cited by the staff stand solely for the proposition that a company cannot set rates with individuals for that is the province of the Public Service Commission, and that rates as such are not the issue here. The Public Counsel would distinguish connection fees from "rates". Public

Counsel, in his brief, concedes that the courts are the proper forum for determining the legal effect of the restrictive covenant, but states that the Commission must recognize that the lot purchasers have already paid for the sewer system. Public Counsel states, in his brief, that each purchaser of each lot was led to believe that the cost of the sewer was included in the purchase price.

The Commission is of the opinion that the holdings of Kansas City Power and Light Co. and Kansas City Bolt and Nut Co. are not so narrow as to exclude those classes of charges commonly known as connection fees, which are charges levied as conditions precedent to receiving service. The Commission also disagrees with the assertion of the Public Counsel that each purchaser was led to believe that the cost of a sewer system was included in his purchase price. A close reading of the transcript reveals highly conflicting testimony on that issue. Those public witnesses who so testified had purchased their lots from three different individuals. There was one witness who testified that he was led to so believe by Mr. Bien and the testimony of Mr. Bien contradicted the assertion. The Commission realizes that it is not possible from this contradictory record to precisely reconstruct what representations were made to each purchaser. We note, however, that the existence of the restrictive covenant appeared to be a matter of general knowledge due to its recordation and presence in the abstracts of title to the lots. Yet, the the record contains no evidence that the sewer system was, in fact, paid for. One can only surmise what were the intentions of the original subdividers when they recorded that covenant.

The Public Counsel has, in addition, taken the following positions:

1. That connection fees are involuntary contributions to capital which should not be required as a prerequisite to utility service;

2. That if connection fees be required the Company be encouraged to issue stock in exchange for the involuntary contribution to capital;

3. That if connection fees are required the customers be permitted to pay those in installments rather than borrow from lending institutions.

4. That if connection fees are required the Company not be allowed to levy an interest charge on customers who choose to connect to the system after one year from the date service is offered.

The Commission agrees that connection fees are involuntary capital contributions, however, we also note that traditionally the Commission does not allow these contributions to go into utility plant rate base, therefore, the utility company earns no profit on the contributed capital. Also, this is at times the only feasible way to accomplish construction of a water or sewer system, as it is not likely that lending institutions would choose to loan 100 percent of the capital required to construct a system and have that loan secured solely by liens upon utility property. Connection fees are not wholly detrimental to those who pay them, as a sewer system in place adds to property values. In the instant case the applicant has investigated the possibility of a public sewer district, only to discover that Stoddard County, as a third class county, may not by law issue the necessary bonds. In light of the facts in this case, the Commission rejects the Public Counsel's contention that connection fees are inappropriate.

In addressing the second contention of the Public Counsel, that the Company be encouraged to issue stock in exchange for the connection fees, the Commission notes that Applicant's president testified at the public hearing that the Company would be willing to issue common stock to its customers. This is a matter solely within the discretion of the management of the sewer company and not a regulatory matter. Certainly, the Commission would never discourage equity ownership by the customers of a public utility. The Commission is aware of the situation presented by contributions in aid of construction in small water and sewer companies, where customers are required to provide funds to build part of the utility plant and therefore become quasi-investors, but they receive nothing tangible to evidence their investment. The Commission is also aware that if a utility built largely by customer contributions is sold, there is the possibility the customers may have to pay for the plant twice, since they would normally reimburse the purchaser's cost through rates. In order to reduce the possibility of customers paying for this system twice, the Commission finds that the Company should, in light of its expressed intent not to "capitalize off anybody", file a tariff which provides that any plant (or portion thereof) constructed with customer'supplied capital shall be donated to a purchaser of the system. The Company would be free to engage in arm's-length negotiation for the sale price representing the value of the investment made by the Company itself.

The position taken by Public Counsel to the effect that the customers be permitted to pay connection fees in installments rather than to borrow from lending

institutions does not seem practical to us. The sewer system needs expeditious construction on a predetermined schedule without excessive cash flow problems. The evidence of record is that local banks stand ready to extend long term mortgage credit to the lot owners for the purpose of financing their sewer connection fees. Also, if the connection fees are not paid in lump sums the sewer company will have to incur short term debt to finance construction. The interest on the short term debt would ultimately have to be paid by the ratepayers, as such is customarily considered to be a legitimate operating expense. The payment of the fees over the life of the homeowner's mortgage should impose less of a burden on him.

The issue of the twelve percent interest charge proposed to be levied upon those residents who fail to connect within the first year warrants discussion. The rationale behind this is best exemplified by the testimony of staff witness Bill Sankpill:

> "It was my understanding that for the first 105 customers that connected up, if they connected within one year from the time that the facilities were ready for service, and the tariff is in effect, of course, then the charge would be $1,035. All right. If a customer chooses to, having been advised by the Company, as Mr. Bien indicated they are willing to do, to wait that year, then there would be approximately a $100 interest expense, which would be 12 percent on $835. That $835 is the expense that the Company is going to have to put out of their pocket right away, because they are going to have to build this system.
>
> "Now the other $200 average would be spent at the time the customer hooks on, so there wouldn't be any interest expense on that. So that was my reasoning, and their agreement, on the $100 or the 12 percent interest expense." (Tr. 173, 174).

The Public Counsel takes issue with the imposition of this charge, stating that some customers may have to pay the connection fee prior to construction of their homes or incur the additional $100 interest expense. Public Counsel contends that it is foreseeable that the 92nd, or perhaps the 103rd, 104th or 105th customer will be required to pay the finance charge; yet, the 106th customer who will be served by the next treatment plant, will not be required to pay the finance charge. Public Counsel's brief states that it seems ludicrous to force future customers to pay for a system that they were not using. Public Counsel also states that the interest charge will act as a disincentive as more customers approach the demand level for additional capacity.

The staff, in its brief, contends that the Public Counsel's argument indicates a misunderstanding of the derivation of the interest charge. The staff points out that the $1,035 connection fee was derived from the costs of the facilities to be used by the customers on the <u>first</u> treatment plant. The staff

calculated costs and then divided by the number of customers to use those facilities. For example, the treatment plant costs were divided by 105, its capacity. The collecting sewers' total cost was divided by 270, the total number of lots in the Company's area. The connection fee is, in effect, "weighted" so that people who will not be on the first treatment plant will not be paying for it, but they will be paying for their share of the collecting sewers and their share of a future treatment plant when one is started.

We are of the opinion that the proposed interest charge on connection fees paid one year after the system goes into operation is reasonable and will act as an incentive for lot owners to request service during the first year of operation. Assuming that the 105th customer does not pay the connection fee during that first year, the fact remains that the sewer company has committed borrowed funds for a period of at least one year in order to complete the plant designed to serve that customer. The seeming anomaly that the 106th customer does not incur the interest charge is explainable by the fact that the treatment facilities to serve him are separate from those serving the 105th customer and construction therefor would have been commenced at a later point in time. Finally, the Commission believes the twelve percent interest charge to be just as used herein.

The Commission is of the opinion and concludes that the stipulation and agreement reached by the Commission staff and the applicant is just and reasonable and that the construction of the proposed sewer system is necessary and convenient for the public service.

It is, therefore,

ORDERED: 1. That Stoddard County Sewer Co., Inc., be, and is, hereby granted a certificate of public convenience and necessity to construct, install, own, operate, control, manage, and maintain a sewer system for the public located in an unincorporated area in Stoddard County, Missouri, described as follows:

WESTERN HEIGHTS SUBDIVISION

Part of the Northwest Quarter (NW 1/4) of the Northeast Quarter (NE 1/4) and part of the Northeast Quarter (NE 1/4) of the Northwest Quarter (NW 1/4) of Section 32, Township 25 North, Range 10 East, described as follows: Beginning at the southeast corner of the Northwest Quarter (NW 1/4) of the Northeast Quarter (NE 1/4) of Section 32, Township 25 North, Range 10 East; thence south 89° 15' west along the quarter-quarter section line, 1927.6 feet; thence north parallel to the west line of the Northeast Quarter (NE 1/4) of the Northwest Quarter (NW 1/4) of Section 32 aforesaid, 400 feet; thence south 89° 15' west parallel to the south line of the Northeast Quarter (NE 1/4) of the Northwest Quarter (NW 1/4) 500 feet; thence north parallel to the west

line of the Northeast Quarter (NE 1/4) of the Northwest Quarter (NW 1/4) 610 feet; thence north 89° 15' east parallel to the north line of said Section 32, 1828.72 feet; thence south parallel to the west line of the Northwest Quarter (NW 1/4) of the Northeast Quarter (NE 1/4) 610 feet; thence north 89° 15' east, parallel to the south line of the Northwest Quarter (NW 1/4) of the Northeast Quarter (NE 1/4) 505 feet; thence south along the east line of the Northwest Quarter (NW 1/4) of the Northeast Quarter (NE 1/4) [illegible] feet to the point of beginning, containing 42.7 acres, more or less.

ECOLOGY ACRES SUBDIVISION

That part of the Southeast Quarter (SE 1/4) of the Northwest Quarter (NW 1/4) of Section 32, Township 25 North, Range 10 East, and all of the Southwest Quarter (SW 1/4) of the Northeast Quarter (NE 1/4) of Section 32, Township 25 North, Range 10 East, more particularly described as follows: Beginning at the southwest corner of the Southeast Quarter (SE 1/4) of the Northwest Quarter (NW 1/4) of Section 32, Township 25 North, Range 10 East; thence north 0° 03' east along and with the quarter-quarter section line 1110.0 feet; thence north 89° 15' east 281 feet; thence north 15° 30' east 218.7 feet to a point on the north quarter-quarter section line of the Southeast Quarter (SE 1/4) of the Northwest Quarter (NW 1/4) of aforesaid Section 32; thence north 89° 15' east along and with aforesaid quarter-quarter section line 2312.6 feet to the northeast corner of the Southwest Quarter (SW 1/4) of the Northeast Quarter (NE 1/4) of aforesaid Section 32; thence south 0° 30' west along and with the quarter-quarter section line 1320 feet to the southeast corner of the Southwest Quarter (SW 1/4) of the Northeast Quarter (NE 1/4) of aforesaid Section 32; thence south 89° 15' west along and with the quarter section line 2642.2 feet to the point of beginning, containing 78.06 acres, more or less.

ORDERED: 2. That Stoddard County Sewer Co., Inc., within thirty (30) days from the effective date of this Report and Order, shall file with the Commission for its approval a schedule of rates, rules and regulations substantially in conformity with this Report and Order.

ORDERED: 3. That the tariff mandated in Ordered 2 above include a provision that any plant (or portion thereof) constructed with customer-supplied contributions or connection fees shall be, in the event of subsequent transfer of utility property, donated to the purchaser of the system and that no consideration be received by the Company for the transfer of such customer-supplied assets.

ORDERED: 4. That Stoddard County Sewer Co., Inc., notify the Commission by letter when sewer service to the public is commenced in this newly certificated area.

ORDERED: 5. That Stoddard County Sewer Co., Inc., submit to the Commission for its approval, prior to commencing sewer service, a proposed form of notice to its customers of the connection fee and of the time period within which such fee may be paid without interest due.

ORDERED: 6. That Stoddard County Sewer Co., Inc., be, and is, hereby ordered to keep and maintain its books of account in conformity with the Uniform System of Accounts for sewer companies as promulgated in 4 CSR 240-61.020.

ORDERED: 7. That nothing herein shall be considered as a finding of value for ratemaking purposes of the property herein involved other than for purposes of this proceeding.

ORDERED: 8. That this Report and Order shall become effective on the 11th day of September, 1979.

BY THE COMMISSION

D. Michael Hearst

D. Michael Hearst
Secretary

(S E A L)

Slavin, Chm., McCartney, Fraas
and Dority, CC., Concur.
Bryant, C., Absent.

Dated at Jefferson City, Missouri,
on this 31st day of August, 1979.