

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF LOCKWOOD ESTATES)
DEVELOPING CORPORATION FOR AN)
ADJUSTMENT OF RATES PURSUANT TO THE) CASE NO. 9627
ALTERNATIVE PROCEDURE FOR SMALL)
UTILITIES)

O R D E R

IT IS ORDERED that:

1. The Staff Report for Lockwood Estates Developing Corporation ("Lockwood") attached hereto as Appendix A shall be included as a part of the record in this proceeding. In the event a public hearing is held, staff preparing the Staff report will be available for cross-examination.

2. Lockwood shall also have until the close of business October 31, 1986, to file written comments concerning the contents of Appendix A. In the event Lockwood desires a public hearing, it shall file a Motion requesting such hearing, with a copy to all parties of record.

Done at Frankfort, Kentucky, this 17th day of October, 1986.

PUBLIC SERVICE COMMISSION


For the Commission

ATTEST:

Executive Director

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

STAFF REPORT

ON

LOCKWOOD ESTATES DEVELOPMENT COMPANY

CASE NO. 9627

Prepared By: Mark Frost
Public Utilities Financial
Analyst, Senior
Water and Sewer Revenue
Requirements Branch
Rates and Tariffs Division

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE COMMISSION
IN CASE NO. 9627 DATED 10/17/86

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

STAFF REPORT

ON

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Requirement Branch
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STAFF REPORT

ON

LOCKWOOD ESTATES DEVELOPING CORPORATION

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PREFACE

On July 7, 1986, Lockwood Estates Developing Corporation ("Lockwood Estates") filed its application seeking to increase its rate pursuant to the Alternative Rate Filing Procedure for Small Utilities. The proposed rate would generate approximately \$12,283 on an annual basis, an increase of approximately 140 percent in the rate currently being charged.

As part of its endeavor to shorten and simplify the regulatory process for utilities the Commission chose to perform a limited financial review of Lockwood Estates' operations for the test year, calendar year 1985. The Commission's objective was to substantially reduce the need for written data requests, decrease the time necessary to examine the application and, therefore, decrease the expense to the utility. Mark Frost of the Commission's Division of Rates and Tariffs performed the review on September 4, 1986, at the office of Lockwood Estates in Crestwood, Kentucky.

SCOPE

The scope of the review was limited to obtaining information to determine whether the test year operating expenses as reported in Lockwood Estates' 1985 Annual Report were representative of normal operations and to gather information to evaluate pro forma

adjustments proposed in Lockwood Estates' filing. Expenditures charged to test year operations were reviewed as were the invoices. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

BACKGROUND

Lockwood Estates, incorporated January 27, 1971, began sewer operations in July 1985. Mr. Clore informed Staff that Lockwood Estates consists of two tracts of land, one developed with 76 lots and the other tract yet to be developed. Lockwood Estates treatment plant was originally designed to provide service to 120 customers and presently serves 27, an average addition of 2 customers per year.

FINDINGS

Revenue Normalization

Lockwood Estates recorded annual test period revenues of \$4,756 and per the application provided service to 27 customers at the close of the test period. Based on 27 customers Lockwood Estates' current rate of \$15.75 per month will produce annual revenues of \$5,103 an increase of \$347 over recorded test period revenues. For rate-making purposes Staff recommends the normalization of Lockwood Estates' annual operating revenues by the \$347 difference, in order to reflect the 27 customers currently obtaining service from Lockwood Estates.

Operation and Maintenance Expense

In the course of the field review Staff examined invoices related to test period operation and maintenance expenses. No material discrepancies in the test period level of these expenses were discovered.

Purchased Water

Lockwood Estates proposed a pro forma level of purchased water expense of \$400, an increase of \$310 over the actual test period expenditure. The pro forma level was based on the annualization of the average water cost of the first 6 months of 1986 and resulted in an average monthly water cost of \$33.30.¹ Staff's examination of Lockwood Estates' financial records revealed water cost remained at a constant \$7.46 per month during the test period and that the monthly water cost for the first 6 months of 1986 fluctuated during the first 4 months but returned to the \$7.46 level during the last 2 months. Lockwood Estates could not explain to Staff why purchased water cost increased during the first 4 months of 1986 and then returned to the monthly test period level. Staff is of the opinion that there is insufficient evidence to support Lockwood Estates' pro forma purchased water cost and, therefore, recommends the reduction of Lockwood Estates proposed pro forma purchased water expense by \$310.

Chemical Expense

Lockwood Estates reported test period chemical expense of \$200. Staff questioned Robert Jones, accountant for Lockwood Estates, in regards to test period chemical expense and was

¹ January 1986	\$ 26.43
February 1986	51.62
March 1986	31.54
April 1986	75.29
May 1986	7.46
June 1986	7.46
Average Monthly Cost	<u>\$199.80</u> • 6 = \$33.30

informed that the entire amount was for the deposit on the chemical cylinder. Thus, since the deposit is a nonrecurring expense, Staff recommends that the chemical expense of \$200 be removed from test period operating expenses.

Supplies Expense

Lockwood Estates reported test period supplies expense of \$401. Staff discovered during the review that chlorine tablets in the amount of \$171 was mistakenly capitalized rather than expensed. Lockwood Estates depreciated this expenditure over a 5 year period, resulting in a yearly depreciation expense of \$34. Therefore, Staff recommends that test period supplies expense be increased by \$171 and test period depreciation expense be decreased by \$34 for a net increase of \$137 to test period operating expenses.

Maintenance Expense

Lockwood Estates reported test period maintenance expense of \$1,318. Staff noted upon reviewing Lockwood Estates' invoices that \$918 of test period maintenance expense was for clearing the sewer lines. Lee Clore, owner of Lockwood Estates, stated that this clearing was due to cement being poured into Lockwood Estates' sewer lines. Staff is of the opinion that this is an extraordinary and nonreoccurring expense and recommends that test period maintenance expense be amortized over a 3 year period. This adjustment reduces test period maintenance by \$918 and increases test period depreciation and amortization expense by \$306 for a net decrease of \$162 to test period operating expenses.

SUMMARY

Based on the recommendation proposed by Staff in this report
Lockwood Estates' operations are as follows:

	<u>Lockwood Pro Forma</u>	<u>Staff Adjustments</u>	<u>Staff Recommended</u>
Operating Revenues:			
Residential & Commercial	\$ 4,756	\$ 347	\$ 5,103
Discounts	0	0	0
Total Operating Revenues	<u>4,756</u>	<u>347</u>	<u>5,103</u>
Operating Expenses:			
Purchased Water	400	(310)	90
Electricity Expense	4,434	0	4,434
Chemical Expense	200	(200)	0
Supply Expense	401	171	572
Testing Expense	2,220	0	2,220
Routine Maintenance Expense	1,800	0	1,800
Maintenance Expense	1,318	(918)	400
Agency Collection Fee	324	0	324
Outside Services Expense	350	0	350
Depreciation Expense	3,741	272	4,013
Property Tax Expense	309	0	309
Public Service Commission Assessment	50	0	50
License Fee-City of Louisville	85	0	85
Office Sharing Expense	1,200	0	1,200
Total Operating Expenses	<u>16,832</u>	<u>(985)</u>	<u>15,847</u>
Net Operating Income	<u>(\$12,076)</u>	<u>\$1,332</u>	<u>\$(10,744)</u>

REVENUE REQUIREMENTS

Lockwood Estates based its requested increase upon the pro forma operating expenses of \$16,832 and 50 percent of Lockwood Estates developed lots being occupied to arrive at a monthly rate

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REVENUE REQUIREMENTS

Lockwood Estates based its requested increase upon the pro forma operating expenses of \$16,832 and 50 percent of Lockwood Estates developed lots being occupied to arrive at a monthly rate

of \$37.91.² According to Lockwood Estates' 1986 Annual Report the treatment plant was designed to serve 120 customers while Lockwood Estates presently provides service to only 27 customers. This amounts to approximately 77 percent excess capacity. Lockwood Estates proposed rate reflects the excess developed lots and not the actual access capacity of the plant. Staff using normalized operating revenue, adjusted operating expenses, 50 percent of the 120 customers the plant was designed to serve and an operating ratio of 88 percent has computed a montly rate of \$25.³

Staff recognizes that Lockwood Estates' proposed rate is a severe increase in the rate currently being paid by the customers of Lockwood Estates, however, in the past these rate had been subsidized by the developer in order to promote the development of Lockwood Estates. In Case No. 9445⁴ the Commission directed the developer of Lockwood Estates to notify its current and potential customers of rate increases that could be expected if this subsidy ended. This notice was directed to be as follows:


2	Lockwood Estates' pro forma expenses	\$16,832
	Divided by: 37 customers	
	76 Lots at 50% capacity	+37
	Sub-Total	<u>\$454.92</u>
	Divided by: 12 months	+12
	Monthly sewer rate	<u>\$ 37.91</u>

3 \$15,847 (Staff Recommended Operating Expenses) + 88% - \$18,008 + 60 (Customers) = \$300 + 12 (months) = \$25.

4 Adjustment of Rates of Lockwood Estates Development Corporation and Request Under Proposed 807 KAR 5:076 to Dispense with the Formal Hearing Requirement, issued April 7, 1986.

The current rate for sewer treatment services for the subdivision is not sufficient to cover operating expenses without a subsidy from the developer. If development does not continue as anticipated, your sewer rate may increase substantially.

Should the developer wish to continue this subsidy an approach utilized by other utilities in the past has been a sharing of expenses between the utility and the ratepayers. Based upon the continuance of the rate subsidization by the developer and an equal sharing of expenses staff recommends that the monthly rate for sewer service be increased to \$25 to produce annual revenue of \$8,100 and increase of \$2,997 over test period normalized revenue.


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Analyst, Senior
Water and Sewer Revenue
Requirements Branch
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