BEFORE THE NEBRASKA PUBLIC SERVICE COMMISSION

In the Matter of Lakeland Estates Water Company, Omaha, seeking to increase water rates effective July 1, 2005.	)	Application No. W-010
	)	GRANTED
	)	Entered: November 22, 2005

For the Applicant:

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BY THE COMMISSION:

O P I N I O N A N D F I N D I N G S

By application filed April 26, 2005, Lakeland Estates Water Company (Lakeland/Applicant), Omaha, seeks authority to increase its water rates effective July 1, 2005. Notice of the application was published in The Daily Record, of Omaha, Nebraska on May 12, 2005. The Public Service Commission (Commission) received the requisite number of petition signatures requesting a hearing on Lakeland's application to increase rates and entered an order on July 28, 2005 scheduling a hearing. Notice of a September 14, 2005 hearing date was published in The Pilot Tribune, of Blair on July 5 and 12, 2005, The Telegram, of Columbus, on July 6 and 13, 2005, and The World Herald, of Omaha on July 1 and 8, 2005.

On July 27, 2005, Applicant filed a motion with the Commission to continue the hearing. The Commission entered an order granting the motion for continuance on August 2, 2005. Notice of the continued hearing date was published in The Enterprise, Blair, on August 5 and 12, 2005, The World Herald, Omaha, on August 4, 2005, The Telegram, Columbus, on August 4 and 11, 2005, and The Daily Record, Omaha, on August 3, 2005. Notice of the hearing was mailed by first class mail to the customers of Lakeland on August 3, 2005. A hearing on the application was held on October 3, 2005, in the City Council Chambers located in the Blair City Hall, 218 South 16th Street, Blair, with appearances as shown above.

E V I D E N C E

The Applicant produced two witnesses. Mr. Dennis L. Carlson, a certified public accountant and custodian of Lakeland's financial records and Mr. Ronald Henn, the owner/operator of Lakeland. Mr. Carlson prepared the financial statements offered by Lakeland. Mr. Ronald Henn has been providing service to Lakeland since 1970. He and his wife are the sole shareholders of Lakeland. Mr. Henn serves as President of Lakeland and is a certified Class 3 water system operator. Lakeland is organized as a Subchapter "S" Corporation under the Internal Revenue Code. Lakeland has approximately 450 subscribers served by 4 wells.

The Commission produced one witness, Mr. Steven G. Stovall, a staff accountant, who participated in a review of the financial records of Lakeland.

The Applicant alleges that its existing rates and charges do not provide an adequate return on its investment in the water plant and equipment and seeks to increase rates as follows:

Type of Service	Present Rate	Proposed Rate
Minimum Charge	$6.00 + sales tax	$6.00 + sales tax
First 30,000 gallons	$2.50/1000 gallons + sales tax	$3.00/1000 gallons + sales tax
Over 30,000 gallons	$3.00/1000 gallons + sales tax	$3.50/1000 gallons + sales tax

Mr. Carlson presented testimony regarding his adjustments to the Commission staff's analysis of revenue, expenses, and plant investment. He introduced a series of schedules numbered one through five to clarify his testimony.

Mr. Stovall testified that he had examined the books and financial records of Lakeland and submitted written testimony and exhibits. He explained the Commission staff's analysis and the reasoning behind the adjustments made by the staff.

First, Mr. Carlson addressed the net plant in service determination. He adjusted the depreciation expense used to calculate the net plant in service to reflect a partial year's depreciation instead of the full year depreciation employed by

Commission staff. Mr. Carlson’s adjustment resulted in a higher net plant in service amount.

Mr. Stovall testified regarding the changes and adjustments made by Commission staff to the net plant in service figure, including a normalization adjustment to eliminate one easement payment and reclassification of certain expenses. Staff employed a full year depreciation figure in their analysis, not the partial depreciation method proposed by Mr. Carlson. Further, staff did not include a $9,049.77 plant asset in the net figure that was included in Mr. Carlson’s calculations.

Next, Mr. Carlson stated that he included a professional services fee of $2,400 for the test year, which reflected the entire cost of attorney fees related to this rate application. Upon cross-examination, he stated that he viewed it as a current expenditure, not a long-term expenditure.

On the issue of professional service fees, Mr. Stovall testified that historically Lakeland has come to the Commission in approximately 5-year intervals. In the staff’s view, it is inconsistent under normalization accounting practices to expense the entire cost of attorney’s fees related to this proceeding in one year. Commission staff recommends amortizing the expense over a period not to exceed five years.

The next adjustment proposed by Mr. Carlson concerned the method of calculating the amount of sales tax removed from the final figures for both revenue and expenses. Mr. Carlson proposed a “true up” based on sales tax recorded per billing system.

Mr. Stovall explained that sales tax, under normalization accounting, is removed from both the income and the expenses components regardless of actual numbers. Mr. Stovall attributed the difference between the Commission staff’s sales tax figure and Lakeland’s sales tax figure to the time difference between collecting and remitting the sales tax to the governmental jurisdiction.

Mr. Carlson next addressed compensation for the water operator and proposed three scenarios, no increase in wages, a $3,000 per year increase in wages, and a $23,000 per year increase. He testified that currently Mr. Henn, as operator, is receiving $12,000 per year compensation for his services. Mr. Carlson provided information on average salaries of water operators from the American Waterworks Association for comparison to the three proposed salary increases. During cross-examination, Mr. Carlson also testified that Mr. Henn, his wife, and his assistants, Doug Bagle and Tim Roberts, received health insurance provided by Lakeland.

Concerning the proposed increase to the water operator salary, Mr. Stovall testified that in prior rate cases with Lakeland, the Commission had allowed some flexibility in the amount Lakeland compensated the water operator. Mr. Stovall referenced a previous Commission order in docket W-006 wherein the Commission authorized Lakeland a range of return rates from 7.46 to 10.53 percent depending on the wage taken by the operator.

As to insurance coverage, Mr. Stovall testified that Commission staff had itemized the expenses included in the insurance expenses heading. These expenses include various health care policies, workman's compensation insurance and personal liability insurance.

Mr. Carlson further testified that his calculations included the cost of maintaining and repairing the Allen Hills subdivision water system, which was donated to Lakeland. He calculated the value of the Allen Hills addition to the water system to be approximately $246,000.

Finally, Mr. Carlson testified to issues not shown on the schedules presented to the Commission. According to Mr. Carlson, Lakeland had invested in a new water storage tank at a cost of approximately $40,000, had made various repairs and improvements to other Lakeland wells at a cost of approximately $33,000. Mr. Carlson stated that Mr. Henn loaned Lakeland $35,000 to complete such improvements. Upon cross-examination, Mr. Carlson also stated that Mr. Henn was not charging interest on the money he loaned Lakeland.

Mr. Henn also testified for Lakeland. Mr. Henn presented evidence of current water rates charged by the villages of Herman, Kennard, and Arlington, the city of Fort Calhoun, the Papio-Missouri River Natural Resource District, the Logan East RWS, and SIRWA serving Creston, Iowa, to demonstrate that Lakeland's rates fall below the average rate in the area.

Mr. Henn testified that as Lakeland's water operator he worked approximately 50 hours per week for Lakeland and outlined a variety of tasks and duties he performed. Concerning his salary, Mr. Henn stated that when funds were available he drew a salary of $12,000 per year. Mr. Henn further testified that he was assisted by a Mr. Tim Roberts and on occasion a Mr. Doug Bagle and employed a bookkeeper.

Mr. Henn's testimony also contained information on water testing performed on Lakeland's wells and the water quality provided by Lakeland's system. Lakeland had received good reports from the state on water quality and no problems or concerns regarding water quality had arisen in the past year.

Mr. Henn also testified concerning an incident that occurred on or about August 3, 2004, at which time a water storage tank located in Allen Hills subdivision exploded. He testified that the cost to repair the tank was $40,470.79, only $5,200 of which was reimbursed by insurance. Mr. Henn testified that he personally loaned Lakeland $25,000 and Mr. Henn's company, Lakeland Development, loaned Lakeland $10,000 to assist with Lakeland's expenses to replace the tank.

One customer of Lakeland also presented testimony with respect to the proposed rate increase and the service provided by Lakeland.

O P I N I O N A N D F I N D I N G S

From the evidence adduced and being fully informed in the premises, the Commission finds:

Lakeland's application is governed by Neb. Rev. Stat. §75-1002 to 75-1012 and Chapter 6 of Title 291 of the Neb. Admin. Code. Pursuant to 002.05, a private water company which proposes to change any of its existing rates or charges must provide notice to its customers and to the Commission of the proposed rates or charges. When a petition containing more than 25 percent of the private water company customer signatures is filed with the Commission, the Commission must set the matter for a public hearing to consider the proposed rate increase.

Both the Applicant and the Commission staff used the same test year (the actual results for the calendar year ending July 31, 2005). Both Lakeland and Commission staff agreed to certain adjustments and based upon supplemental Exhibit No. 14 that was late-filed and accepted by the Commission, Lakeland's proposed rate base (Net Plant in Service) for the test year ending on July 31, 2005, is calculated as follows:

Total Plant in Service	$692,604.22
Accumulated Depreciation	$315,025.90
Net Plant in Service	$377,578.32

The staff exhibits originally did not include a $9,049.77 plant addition. Commission staff and Lakeland agreed that the additional asset should be included in the computation of net plant resulting in identical total plant in service figures from both staff and Lakeland. Staff's adjusted rate base as of July 31, 2005, therefore, is calculated as follows:

Total Plant in Service	$692,604.22
Accumulated Depreciation	$316,223.53
Net Plant in Service	$376,380.69

Staff calculated depreciation expense based on a normalized approach which assumes assets are in service for the entire year regardless of the month any particular asset was put into service. Lakeland proposed a monthly depreciation rate based on the actual monthly plant in service. We agree with the staff that normalizing depreciation expense will more accurately reflect the depreciation expenses going forward and this treatment results in a depreciation reserve of $316,223.53 and an annual depreciation expense of $23,244.60.

The Commission has not established guideline depreciation rates for private water companies. However, the depreciation rates utilized in the staff's calculation are the suggested rates, lives and salvage values related to Class "C" water company as adopted by the National Association of Regulatory Utility Commissioners (NARUC). The Applicant's accountant did not object to the staff's method of calculating depreciation, but suggested that the staff over-depreciated some of the items due to the normalization method. We find the staff calculations and post-hearing adjustments with respect to depreciation and net plant in service figures are fair and reasonable.

Applicant proposes that the Commission increase the allowable water operator wages by approving an adjustment to the test year expenses. The water operator, Mr. Henn, was authorized to receive a recognized $12,000 per year in compensation during the previous rate review (W-006). Applicant offered three scenarios concerning management fees and officer's wages including no increase in the operator's wages, a $3,000 per year increase, and a $23,000 per year increase. Applicant relies on figures from the American Water Works Association contained in late-filed Exhibit No. 10 to support a $23,000 per year increase. Applicant's accountant testified that water operators with similar education and experience to Mr. Henn are receiving approximately $30,000 to $40,000 per year in compensation.

We find that a $23,000 increase would present a heavy burden on ratepayers of Lakeland. We do not find it appropriate or fair to the ratepayers to include such a large one time increase in light of Mr. Henn's own admission that he does not take the full salary currently allowed under the existing rate structure. An analysis of past water rate dockets, including W-006, Lakeland's 2001 water rate docket, shows reasonable increases in operator wages were allowed. In W-006, this Commission went further and allowed flexibility by establishing a range in the rate of return Lakeland could realize based directly on what Lakeland chose to pay the operator. The operator decided not to include the $9,000 increase in wages authorized by this Commission and took the higher rate of return in the alternative. We find that a $3,000 increase in operator compensation is both reasonable and customary under normalization accounting practices, and therefore it will be allowed.

Staff and the Applicant's accountant disagreed on the proper method to include the $2,400.00 of legal fees resulting from this docket. Staff recommended a maximum of 5 year amortization and Applicant's accountant proposed a one time inclusion of the entire amount. We find that based on the history of Lakeland's past applications for a water rate change in front of this Commission, amortizing the professional fees directly related to the rate process over a 3 year period is both fair and reasonable. Therefore, $800.00 of the total fee will be allowed for the test year period.

We next consider the sales tax calculation issue. Staff and Applicant's accountant offered differing figures on the amount of sales tax that should be removed from both revenue and expenses. Applicant proposes a "true-up" sales tax based on billing minus what was expensed during the test year and proposes a $349.17 increase in the sales tax adjustment. Staff maintains that the difference between billed sales tax and paid or expensed sales tax is the timing between collection and remittance. Sales tax is paid in arrears. We agree with the staff analysis and find that under normalized accounting practices, sales tax should be removed from both revenue and expense, regardless of when it is billed or remitted. Therefore, we find the reasonable and fair sales tax adjustment to be $9,191.44 resulting in total net taxes of $1,665.65 for the test year.

The impact the proposed rate increases will have on Lakeland’s customers is another area where staff and Applicant disagree. Based on the information submitted to the Commission, applicant appears to be calculating the impact using 430 customers. However, the notice sent to Lakeland customers of the proposed rate change indicated the number of customers served by Lakeland to be 450 customers. We therefore, find it to be reasonable and consistent to use the 450 number in the calculation of customer impact from the rate change. We also agree with staff that 450 is more representative of the actual number of customers affected by the rate increase. Based on these findings the effect on customers by the proposed rate increase will be $3.90 per month.

We also take note that the Applicant inquired as to the inclusion of the plant at the Allen Hills subdivision for ratemaking purposes. The Commission requested additional information from the Applicant concerning the plant. The Applicant submitted and the Commission accepted Exhibit No. 11 which contained the requested information. Upon review of the information, staff recommended that the plant in question not be included in the rate base for ratemaking purposes. Lakeland did not purchase the Allen Hills subdivision plant, it was donated to Lakeland. We find the staff position to be fair and reasonable and therefore we will not increase the net plant in service to reflect the addition of the Allen Hills subdivision. We realize there will be maintenance on this plant and those expenses should be accounted for and considered in setting future rates.

Review of an Applicant’s proposed rate increase should be based on consideration of reasonableness in light of the circumstances individual to each case. Typically, when a company like Lakeland takes on additional investments and undergoes expansion, the result is a lower rate-of-return.

The financial statements in the record reflect that during the test year, Lakeland earned a rate-of-return of 3.5 percent. After adjustments for the proposed operator wage increase, normalized treatment of sales tax and depreciation, amortization of the professional fees, and an increase in revenue generated from the proposed rates, we find the adjusted Net Operating Income to be $26,754.71. Using the test year rate base of $376,380.69 Lakeland would be earning a return of 7.11 percent after the rate increase.

Lakeland has made additional investments in its infrastructure to accommodate the expansion of its customer base, and we find that the proposed increase places the Applicant in a reasonable position. Therefore, having considered all of the evidence, we are of the opinion that the proposed increase of $.50 per 1,000 gallons for the first 30,000 gallons and $.50 per 1,000 gallons over 30,000 gallons is fair and reasonable and the application should be granted.

We also address the issue raised at the hearing by one of Lakeland’s customers concerning the remains of the water tank that exploded in the Allen Hills subdivision. We have no authority to require clean up of any unsightly remains, however, we do urge Lakeland to address the clean-up of any remaining evidence of the explosion in as timely a manner as possible.

O R D E R

IT IS THEREFORE ORDERED by the Nebraska Public Service Commission that Application W-010 be, and is hereby, granted and Lakeland Estates Private Water Company be, and it is hereby authorized to charge and collect water rates set forth in the Opinion and Findings.

MADE AND ENTERED at Lincoln, Nebraska, this 22nd day of November, 2005.

NEBRASKA PUBLIC SERVICE COMMISSION

COMMISSIONERS CONCURRING:

Chairman

ATTEST:

Executive Director