

TRAFFIC DOCKET ROOM
RY AUTHORITY

November 14, 2007

STAFF REPORT

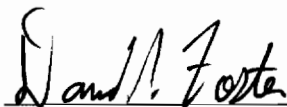
The TRA Wastewater Rules are intended to ensure continued adequate and reasonable service. This docket was opened to consider whether the escrow account maintained by Kings

Chapel Capacity, LLC. ("Kings Chapel" or "Company") is adequate or should be adjusted to comply with the intent of the Authority Rules.

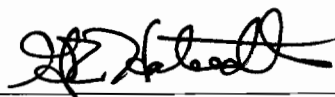
At the June 25, 2007 Authority Conference, this docket was heard to determine whether the \$10.13 per month escrow rate is sufficient to fund system component replacement and/or tank pumping as needed. The Panel deferred consideration of the issues presented in this docket until such time as the Authority obtained information to specifically assess the purpose of the escrow account, whether the financial condition of the company requires the establishment of an escrow account, and the appropriate escrow rate if one is required. At the October 22, 2007 Authority Conference, the Panel considered action in this docket. John Powell, representing Kings Chapel, expressed concern stating that he was unsure of the action that the Authority was taking regarding his company. Pursuant to the Panel's discussions with Mr. Powell and upon further deliberations, it was decided that Staff would issue a report regarding Kings Chapel's escrow fund and the Company would have an opportunity to respond to the report prior to the Panel's deliberations.

The Utilities Division hereby files its Report with the Tennessee Regulatory Authority as a public record and requests consideration of the recommendations contained therein.

Respectfully Submitted:



David Foster, Deputy Chief
Utilities Division
Tennessee Regulatory Authority



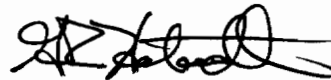
Gary Hotvedt, Counsel
Legal Division
Tennessee Regulatory Authority

CERTIFICATE OF SERVICE

I hereby certify that on this 14th day of November, 2007, a true and exact copy of the foregoing has been either hand-delivered or delivered via U.S. Mail, postage pre-paid, to the following persons:

Eddie Roberson, Chairman
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243

John Powell
Kings Chapel Capacity, LLC
1413 Plymouth Drive
Brentwood, TN 37027

A handwritten signature in black ink, appearing to read 'Gary Hotvedt', written over a horizontal line.

Gary Hotvedt

STAFF REPORT

CONCERNING THE RESERVE/ESCROW ACCOUNT

OF

KINGS CHAPEL CAPACITY, LLC

DOCKET 07-00062

PREPARED BY

TENNESSEE REGULATORY AUTHORITY

UTILITIES DIVISION

NOVEMBER 14, 2007

INTRODUCTION

TRA Rule 1220-4-13-.07 requires a review of the financial condition of each wastewater utility in order to determine whether an escrow/reserve fund should be created to pay for non-routine operation and maintenance expenses for those companies that do not have such funds in place or adjusted for the companies that have an established escrow fund. The pertinent language of the aforementioned TRA Rule provides:

- (8) The requirement for a public wastewater utility to maintain a reserve/escrow account shall be determined by the Authority on a case by case basis. Within eighteen (18) months from the effective date of these rules, the Authority shall review the financial condition of any public wastewater utility holding a CCN to provide wastewater service as of the effective date of these rules to determine whether such wastewater utility shall establish or adjust the amount of a reserve/escrow account as described in this Chapter. Upon the filing of an initial CCN application, a determination shall be made regarding the establishment of a reserve/escrow account. The Authority may review the financial condition of any public wastewater utility at any time to determine whether a reserve/escrow account balance is adequate or an account should be established.
- (9) Reserve/escrow accounts established by the public wastewater utility to pay for non-routine operation and maintenance expenses shall meet the conditions as specified by the Authority. The public wastewater utility shall file bank statements and a report that details the expenses on all disbursements from the escrow account with its annual report or as the Authority may direct. Public wastewater utility employees having signature authority over such account may be subject to a fidelity bond. The public wastewater utility's tariff shall set forth the specific amount charged to customers to fund the reserve/escrow account.

SCOPE OF THE REPORT

Pursuant to the rules, the purpose of this report is to analyze Kings Chapel's existing financial condition and determine (1) whether an escrow fund is necessary and, if so, whether the existing escrow amount should be adjusted and (2) the types of expenses and repairs that may be funded by the escrow.

IS AN ESCROW NEEDED GIVEN THE FINANCIAL CONDITION OF KINGS CHAPEL?

Kings Chapel provides wastewater service and operates with nearly one hundred percent (100%) contributed plant. The Company states that contributed wastewater plant with an original construction cost of \$437,264 was transferred from the developer to the Company in November 2006 at which time the Company began serving customers.¹ The 2006 Annual Report shows utility residential service revenue of \$648 and total operating expenses of \$2,397

¹ Company Data Response, question #1 (March 20, 2007).

for a Net Operating Loss of \$1,749. These amounts, however, are based on only two (2) months of operations.

Kings Chapel is essentially a start-up company and only anticipates serving 218 customers when the Ashby Communities development is fully built out. Accordingly, it might be difficult for the utility to fund major non-routine expenses and/or major repairs should they occur within the first few years of operation. For this reason, Staff contends that is vital to have an escrow account in place to accumulate funds necessary to cover such expenses and/or repairs. This mechanism will provide customers with additional assurance that adequate service can be maintained and assist in insulating ratepayers from rate shock that might be experienced absent an escrow fund.

NON-ROUTINE OPERATION AND MAINTENANCE EXPENSES

The rule states that escrow accounts established shall be used to pay for non-routine operation and maintenance expenses that meet the conditions as specified by the Authority. The rules, however, do not specify or define the precise expenses that will be covered by an escrow fund. Kings Chapel currently charges its customers \$35.11 monthly for sewer service of which \$10.13 is placed into an escrow account. Revenues received from rates, excluding the escrow amounts, are designed to cover annual expenses necessary to operate the utility; such revenues, however, are not designed to cover expenses that do not occur annually. It is these expenses that do not occur annually that should be covered by the escrow account.

As stated previously herein, Kings Chapel is a small wastewater company and may not be in a position to fund equipment replacement should portions of the system fail. Therefore, Staff recommends that in addition to non-routine operation and maintenance expenses, the TRA should determine that escrow funds also be utilized to fund equipment replacement.

In granting Kings Chapel's CCN in Docket 04-00335, the Authority approved a monthly residential escrow amount of \$10.13 to be utilized for replacement and/or major repairs of existing utility equipment and non-routine expenses, which are broken down as follows:

\$3.10	Collection System-Tank Pumping
3.25	Collection System-Equipment Replacement
2.90	Treatment System-Preventative Maintenance
0.88	Disposal System-Equipment Replacement

Consistent with the rationale provided herein, the above categories correctly represent the types of expenses and equipment placement that Kings Chapel's escrow account should fund. For clarity, Staff recommends that the following definitions be adopted to distinguish the types of expenses and equipment replacement that the escrow account should fund:

1. **Equipment Replacement** – Necessary improvements to the wastewater system or to replace vital system components in case of failure. The amount of equipment purchased with

escrow funds funded by ratepayers, however, should not be included in rate base, but rather be treated as contributed capital.

2. Tank Pumping – This expense is non-routine and is generally incurred approximately every five years. Since this expense is not incurred annually, it is not included in the cost of service to be recovered by monthly rates.

3. Preventative Maintenance – This would apply only for unique and extraordinary preventative maintenance that may be required; escrow funds should not be used for annual preventative maintenance that is covered by monthly rates.

AMOUNT OF MONTHLY ESCROW

The Company's 2006 Annual Report indicates an Escrow Fund Balance of \$210 at December 31, 2006.² The Company records these funds in Account 235.1 (Escrowed Deposits) and reports this reserve account as a liability on its Balance Sheet. The Company has not yet separated the escrow funds into a separate bank account to comply with TRA 1220-4-13-.07(9).

Based upon the existing escrow amount of \$10.13 monthly, Kings Chapel will be collecting \$26,500 per year in escrow funds when Ashby Communities is fully built out.³ Furthermore, the Company's newly acquired wastewater plant is less than a year old and has not required any major repairs or replacement. Based on the information provided in data responses, the average weighted service life of the Kings Chapel wastewater systems is approximately 35 years. Accordingly, Staff anticipates little or no withdrawals from the escrow fund for several years, thereby allowing the escrow fund to grow rather quickly. Based upon the number of subscribers forecasted by the Company, Staff analysis indicates that Kings Chapel's approximate year end escrow balances will be:

2007 – \$4,200
 2008 – \$13,300
 2009 – \$28,500
 2010 – \$46,700
 2011 – \$73,200

The escrow amount of \$73,200 by 2011 (four years from now) represents approximately 17% of Kings Chapel's existing contributed plant balance. Given that only portions of the plant should need repairs or require non-routine expenses at any one time, this amount of escrow should allow Kings Chapel to either fund any necessary repairs or expenses or provide the necessary collateral to obtain a loan. As the system grows older, a higher ratio of escrow to plant balance may become necessary. The exact amount of replacement costs and when those funds will be needed, however, cannot be forecasted with certainty. At this time, Staff recommends that the existing escrow amount is sufficient and should be maintained. After a few years of data is captured, including any withdrawals from the fund, Staff will be in much

² Company Data Response, question #3 (March 20, 2007).

³ 218 customers times \$10.13 times 12 months.

better position to advise the Authority regarding future amounts that need to be escrowed and whether funding should be adjusted.

For these reasons, **Staff recommends:**

- 1. The Authority require Kings Chapel to maintain the current escrow rate of \$10.13 for residential customers;**
- 2. That Kings Chapel be directed to establish a separate bank account to administer the escrowed funds that includes a fidelity bond on persons with authority to withdraw such funds;**
- 3. That Kings Chapel be directed to transfer any revenues collected to date into that account and provide proof of compliance to the Authority within thirty (30) days; and**
- 4. That Kings Chapel be directed to file annual calendar year end reports detailing the balances and activity in the Company's escrow account. Details should be included for monthly amounts placed into escrow and for amounts taken out of escrow. These reports should be filed no later than April 1 of each year, concurrent with the filing of its annual report to the TRA.**